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Economic Development and Entrepreneurship: An Empirical Cross-Sectional Study

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Abstract

Entrepreneurship, which entails the establishment and operation of a business, is vital to the growth and progress of the economy. Entrepreneurs promote innovation, which is important not only for dynamic Schumpeterian competition but also for overall economic vitality. This work contributes to the existing corpus of knowledge on entrepreneurship by examining the correlation between entrepreneurship and economic growth through the utilization of cross-section empirical research. All early-stage entrepreneurship is classified into two distinct categories: necessity-driven and opportunity-driven. Additionally, in our sample economies, we differentiate between developed and developing economies. We find no evidence to support the notion that economic growth and overall entrepreneurship are positively correlated. This is logical in light of the extraordinarily varied nature of entrepreneurial activity. Furthermore, our empirical findings underscore the criticality of distinguishing between distinct types of entrepreneurship and economic sectors. Our research specifically examines developing economies that have a substantial manufacturing sector and finds opportunity-driven entrepreneurship to be positively correlated with growth. It is logical to assume that substantial scientific progress in the manufacturing industry would provide innovative entrepreneurs with an abundance of opportunities, whereas the services industry would experience a comparatively sluggish pace of technological advancement for other entrepreneurs.

Keyword- Economic Development, Entrepreneurship, Cross-Sectional

I. Introduction

Entrepreneurship, which entails the establishment and operation of a business, is vital to the growth and progress of the economy. Entrepreneurs play a crucial role not only in fostering dynamic Schumpeterian competition and economic vitality, but also in substantially advancing innovation. Innovation-driven entrepreneurs are primarily responsible for the perpetual Schumpeterian process by which new products, services, technologies, firms, and industries supplant older ones. Numerous Fortune 100 companies are in the process of developing and marketing innovative products that incorporate state-of-the-art technologies. The degree to which the Fortune 100 of 1970 resembles the Fortune 100 of the present day will not be the same. Entrepreneurs who are forward-thinking, revolutionary, and willing to take calculated risks—such as Steve Jobs and his companions when they founded Apple in a suburban California garage—are the impetus behind the perpetual formation of fresh companies offering cutting-edge technologies and products. Street food vendors, despite being ordinary entrepreneurs, are obliged to engage in innovation due to the presence of competition. Thus, not only transformative entrepreneurs make business-related contributions to the economy. Despite exerting a significant influence on economic growth and innovation, entrepreneurs were predominantly disregarded and undervalued. The scarcity of information that existed prior to the emergence of entrepreneurship databases such as the Global Entrepreneurship Monitor (GEM) in recent times has contributed to this situation to some extent. The lack of comprehension and research on a broader level illustrates the inherent difficulty in quantifying entrepreneurship and the factors that motivate entrepreneurial pursuits. Additionally, entrepreneurship is difficult to rationally explain due to the fact that the majority of new businesses fail. Thus, optimism or irrational enthusiasm is required to succeed as an entrepreneur. Additionally, economists have a propensity to disregard entrepreneurship due to its extraordinary diversity. An Accurate Definition of Entrepreneurship Is Difficult Achieving due to the inclusion of street food vendors and transformative innovators such as Elon Musk in its scope. Ordinary entrepreneurs, while also making substantial contributions to the economy, do not affect innovation, productivity development, and economic dynamism to the same extent as game-changing entrepreneurs. Although the likelihood of success is extremely low, transformational entrepreneurs often exhibit a willingness to seize unexplored opportunities and undertake risks. Entrepreneurs who are

audacious, inventive, and creative develop novel products, services, and economic sectors by thinking outside the box. An instance of this is the establishment of a cable TV network by Ted Turner, which broadcast news 24 hours a day, seven days a week, during a time when the majority of individuals predominantly consumed evening newscasts. Nevertheless, forty years later, 24-hour news stations have become the norm. Entrepreneurs possess the ability to transform state-of-the-art technologies into consumer-oriented products and services. Prominent instances of internet applications that have attained financial success encompass Amazon and Google. While entrepreneurs developed the majority of the internet's numerous commercial applications, the public sector played a significant role in laying the groundwork for the technology. Entrepreneurs not only produce goods that are beneficial to consumers but also goods that address the most critical challenges confronting humanity. The vaccine against coronavirus disease (COVID-19) was created by BioNTech, a German biotechnology start-up founded by two forward-thinking entrepreneurs, Drs. The cases of Ugur Sahin and Ozlem Tureci are well-known examples. By encouraging knowledge spillovers and radical innovations, innovative entrepreneurs substantially contribute to economic growth, employment creation, productivity, and social welfare in economies of all income and development levels (Kritikos 2014). Differentiating between ordinary entrepreneurs and inventive entrepreneurs can be a challenging task at times. Prominent restaurateurs, for instance, are those who pioneer novel street food purveyors whose creations are uniquely palatable. However, the economic impact of entrepreneurship is predominantly ascribed to a small number of exceptionally prosperous business proprietors. The investigation of entrepreneurship in developing Asia is primarily driven by the significance of entrepreneurship in driving economic growth and development, in addition to its relative neglect within economic scholarship. Entrepreneurship is the key to the ascent and expansion of a prosperous private sector, which is an essential element of sustained growth. In light of the recent surge in digital entrepreneurship, now is an opportune moment to investigate the motivations that drive individuals to establish novel enterprises. Digital technology and information and communication technology (ICT) have substantially reduced the initial investment requirements of businesses by obviating the necessity for physical infrastructure such as brick-and-mortar stores. ICT reduces the cost of information and communication at its core, thereby enhancing productivity. Entrepreneurs possess several

distinctive advantages, including enhanced collaboration with other stakeholders, cost-effective access to new markets, and opportunities to be exposed to innovative concepts. Moreover, digital technology played a substantial role in bolstering the resilience of entrepreneurs amidst the COVID-19 pandemic. By decreasing sectoral entry barriers, ICT can facilitate inclusive development and growth. For instance, ICT can expand the entrepreneurial opportunities available to women and the poor. This promise is impeded by the digital divide, which remains a substantial barrier to ICT-facilitating entrepreneurship. However, a robust digital infrastructure does not invariably promote entrepreneurial endeavors. The absence of entrepreneurship in a society cannot be solely attributed to digital technology, as numerous factors influence this phenomenon. The decision of whether or not to establish one's own enterprise is fundamentally an individual one. Talented individuals with innovative business concepts who alter the status quo have numerous employment opportunities paying very well. Furthermore, their audacious choice to establish an enterprise is impacted not only by their personal values but also by formal and informal institutions, societal conventions, and the overall business environment (Baumol and Strom 2008, Acs et al. 2008). This applies to ordinary business proprietors as well. An ever-evolving environment fosters entrepreneurship. As a result of organizational innovations such as venture accelerators and crowdfunding, the entrepreneurial environment has recently improved. Also influencing the environment are technological developments such as 5G. Exactly why some individuals decide to start a business while others do not is a matter of debate. However, one thing is certain: the decision to become an entrepreneur is an intricate and multifaceted one.

II. Literature Review

An expanding corpus of literature establishes a connection between entrepreneurship and economic growth, despite the fact that entrepreneurship remains a relatively understudied topic in economics. The empirical research relies heavily on cross-section regressions that employ annual GEM indices of entrepreneurial activity specific to each economy. In general, empirical evidence suggests that economies characterized by greater levels of entrepreneurship tend to experience more rapid growth. The evidence is not wholly conclusive due to the absence of a robust positive correlation between entrepreneurship and economic growth, as indicated by other studies. Moreover, due to the heterogeneous nature of entrepreneurship, caution must be

exercised when extrapolating its effects on growth; distinct strands of entrepreneurship may produce unique outcomes. The relationship between entrepreneurship and growth may also vary across economies characterized by distinct degrees of development and prosperity. Both Schumpeter (1942) and Baumol (1990) recognized the pivotal significance of entrepreneurship in driving economic growth and progress. According to Schumpeter, entrepreneurship is the key to economic expansion and development. In particular, he held the conviction that innovative, transformative entrepreneurs are the principal catalysts for progress in technology, society, and humanity. In other words, creative entrepreneurs function as the primary catalysts for the perpetual process of creative destruction, wherein novel technologies and products consistently replace their predecessors. The Schumpeterian framework posits a close relationship between entrepreneurship and innovation. Certain types of entrepreneurship, according to Baumol (1990), generate larger social productivity than others. The individual emphasized that the overall entrepreneurial climate is a critical determinant of the type of entrepreneurship that will flourish in an economy. Economic progress is propelled, according to Acs (2006), by a combination of prosperous enterprises and successful entrepreneurs. Entrepreneurship positively influences economic growth, according to the findings of a cross-sectional time series panel of economy-specific measures of entrepreneurship conducted by Acs et al. (2005). They conclude that this provides support for the notion that entrepreneurship facilitates the knowledge spillovers that stimulate productivity gains. A Schumpeterian framework was utilized by Galindo and Méndez in a study published in 2013 to analyze the correlation between innovation, entrepreneurship, and GDP in thirteen industrialized economies from 2002 to 2007. A number of variables, including monetary policy and social conditions, support entrepreneurship and innovation, according to their research. They detected an observed feedback effect that was of significance. Entrepreneurship and innovation are stimulated by economic activity, which stimulates further economic activity. Valliere and Peterson (2009) examined the impact of different types of entrepreneurship on the growth of gross domestic product (GDP) in 44 developed and developing countries between 2004 and 2005, utilizing GEM data. Additionally, the Global Competitiveness Report's supplementary control variables are incorporated. It was found that a considerable portion of economic progress in industrialized economies can be ascribed to ambitious entrepreneurs. However, developing countries fail to perceive the positive impacts that

entrepreneurs have on economic expansion. Using fourteen distinct entrepreneurship indicators, Doran et al. (2018) investigate whether various entrepreneurship metrics can account for economic development in an uneven panel of high-income, middle-income, and low-income economies between 2004 and 2011. It is found that entrepreneurship fosters growth in high-income economies but not in middle-income and low-income economies. Conversely, Adusei (2016) reveals that entrepreneurship contributes substantially to the growth of twelve African economies. To investigate the correlation between entrepreneurship and economic growth in 22 Organization for Economic Co-operation and Development economies, Salgado-Banda (2007) employed a novel variable derived from patent data to represent productive entrepreneurship, with self-employment serving as a contingency proxy. In conclusion, the author asserts that a positive correlation exists between the proposed indicator of productive entrepreneurship and economic development. A negative correlation appears to exist between self-employment-based alternative measures and economic growth. Entrepreneurship contributes to economic growth, according to Stoica, Roman, and Rusu (2020), who base their conclusion on panel data encompassing 22 European economies from 2002 to 2018. In particular, their findings suggest that early-stage, opportunity-driven entrepreneurship contributes to economic expansion in the economies under study. Prior to now, the majority of research on the relationship between entrepreneurship and economic growth was conducted in developed nations, as opposed to emergent economies. Further investigation is necessary due to the lack of clarity surrounding the empirical correlation between entrepreneurship and development in emerging economies. According to the findings of Stam and van Stel (2011), although entrepreneurship does not have a direct influence on the growth of middle-income economies, it does contribute to the expansion of high-income economies. For a comprehensive assessment of the impact of entrepreneurs on economic growth in developing nations, it is critical to understand the intricate relationship between market regulation and entrepreneurship, as stated by Lerner and Schoar (2010). An S-shaped correlation has been observed between economic progress and entrepreneurship, according to Acs (2010). Entrepreneurship is conspicuous during the initial phases of development; however, its importance diminishes considerably as the efficiency stage ensues. However, with the shift from an efficiency-centric to an innovation or knowledge-centric phase of the economy, entrepreneurship assumes a more significant role and expands at a quicker rate.

A reinforcement of institutions, according to Acemoglu and Johnson (2005), results in a shift in entrepreneurial activity toward productive entrepreneurship, thereby promoting economic development. Following a period of equilibrium in entrepreneurship, this upswing in activity persists during the efficiency-driven phase and culminates in a significant degree of innovation. Entrepreneurship rates are expected to decline, according to Koster and Rai (2008), as economic development generates more employment opportunities and reduces the necessity for individuals to establish their own businesses. However, the Indian context deviates from this recurring trend. Conversely, it appears that entrepreneurship plays a substantial role in fostering economic growth. One plausible explanation is that India's economy is service-oriented, which consequently fosters the presence of small enterprises. Despite the increase in entrepreneurial activity, the quality and size of small businesses have remained constant over time, as has the proportion of registered firms. It remains uncertain, according to the authors, whether emergent economies gain the same advantages from entrepreneurship as industrialized nations. According to Van Stel, Carree, and Thurik (2005), the relationship between entrepreneurship and economic growth is determined by the GDP per capita indicator of an economy's level of development. Entrepreneurship has a significantly smaller impact on development in developing nations, the authors find. Low levels of human capital and the absence of large corporations are, according to the authors, the causes of the limited impact. Sautet's (2013) findings offer additional substantiation that entrepreneurship does not contribute positively to the development of developing countries. The coexistence of productive entrepreneurship and persistent underdevelopment in numerous low-income economies is a phenomenon that is somewhat puzzling. The distinction between local and systemic entrepreneurship facilitates comprehension of the enigma. By employing network and firm theories, in addition to recent research on social cooperation mechanisms, the author illustrates that rapid expansion of enterprises does not result in economies of scale and scope for local entrepreneurship. This is because systemic entrepreneurship, which capitalizes on opportunities that are sufficiently expansive to transcend the entrepreneur's proximal community, is the sole determinant capable of facilitating exponential expansion.

III. Systematic information and empirical data

In our paper, we employ cross-section empirical analysis to ascertain the relationship between entrepreneurship and economic growth. As one of our primary independent variables, total early-stage entrepreneurship (TEA) is comprised of opportunity-driven early-stage entrepreneurship (OEA) and necessity-driven early-stage entrepreneurship (NEA), according to previous research (see, for instance, Wong et al. 2005 and Valliere and Peterson 2009). The information on these eight entrepreneurship variables was obtained from the GEM, the most widely used source of entrepreneurship data. 1. The principal dependent variables are GDP growth and GDP per capita growth, which are the two most frequently employed indicators of economic expansion. The information utilized for these indicators was obtained from the World Development Indicators database of the World Bank. Furthermore, the sample of economies is subdivided into developing, emergent, and advanced economies. Consideration is also given to the economic structure of an economy. Further, the GDP of an economy is computed by considering the proportional contributions of diverse sectors, such as manufacturing and services. Our empirical investigation is grounded in panel data spanning a duration of 19 years (2001-2019) and 111 economies. The correlation between economic growth and entrepreneurship is illustrated in Figures 1 and 2. Early-stage entrepreneurial activity, including necessity-driven early-stage entrepreneurial activity, exhibits a positive correlation with overall economic growth. Nonetheless, economic expansion and opportunity-driven early-stage entrepreneurship are in opposition. The identification of these cross-sectional patterns suggests that income levels and categories of entrepreneurs in the economy must be accounted for in econometric estimation. A distinct cluster is formed between the industrialized economies, denoted by blue dots, and the emergent and developing economies, symbolized by red dots. Additionally, patterns of variation are evident among the diverse forms of entrepreneurship. Nevertheless, the available evidence regarding the existence of a positive correlation between economic growth and entrepreneurship, specifically total entrepreneurship, is quite scant, as indicated by the correlations themselves. TEA is one of the principal indications incorporated within the GEM database. It is significant because certain TEA entrepreneurs promote innovation, employment creation, and economic expansion. TEA is the percentage of individuals in their working years who are actively engaged

in the establishment or operation of a company less than 42 months old, as reported by GEM. Consequently, TEA encompasses young business proprietors and nascent entrepreneurs who are engaged in novel business undertakings. GEM distinguishes between OEA and NEA, two classifications of entrepreneurial activity, according to individual entrepreneurial motivation. Multiple studies have provided evidence that economic growth is influenced by the form of entrepreneurship. Consequently, we have incorporated these two variables into our analysis. Figure 3 illustrates the correlation between early-stage entrepreneurial activity and economic growth from a cross-sectional perspective. The hierarchy of economies is predicated on the level of entrepreneurship. Figure 3 illustrates the absence of any apparent correlation between entrepreneurship and growth. The correlation between the opportunity-to-NE ratio and the GDP per capita of an economy is illustrated in Figure 4. Acs et al. (2008) posit that the ratio signifies the comparative significance of OE, which frequently exhibits greater productivity, with respect to NEA. The fitted line signifies a positive correlation between the entrepreneurship ratio and GDP per capita. In other words, opportunity rather than necessity is the primary impetus for entrepreneurship in more affluent economies. It is noteworthy that the single-year cross-sectional patterns of 2015 in Figure 3 and Figure 4 differ significantly from the multi-year cross-sectional patterns of 2011-2019 in Figure 1 and Figure 2. This inconsistency suggests that in order to account for any hypothesized two-way causal relationship between entrepreneurial activity and economic growth rates, panel estimates with appropriate controls are required.

IV. Empirical Results

This section presents and reviews the principal findings of our empirical inquiry. A. The regression results, which are presented in Estimation Outcome Tables A5 and A6 of the Appendix, are derived from the fixed-effects estimation of the empirical model's baseline as described in equations (1) and (2). The presentation included the regression results of the exact same models applied to developed, emergent, and developing economies. Additionally, the results of the estimations were displayed individually in Tables A7 and A8, with the exclusion of the control variables. To examine the possibility of a reversal of causality from economic growth to entrepreneurship activity, we took advantage of the latency in entrepreneurship activity rates. Entrepreneurship can impact economic growth, as was previously stated, but economic growth

can also be influenced by entrepreneurship. An instance of a thriving economy may offer increased opportunities for entrepreneurial endeavors. Additionally, in an effort to mitigate the influence of absent data, we incorporated the lag of economic development as an independent variable. The results of the estimations suggest that the interaction between the share of the manufacturing sector and the delays of TEA and NEA has a substantial and positive impact on economic development (Tables A5 and A6). The results indicate that an increase in the manufacturing sector's economic share corresponds to a corresponding rise in the economic development benefits of TEA and NEA. Statistics indicate that the contribution of the manufacturing sector is insignificant. Economic development in emerging and developing nations is significantly and positively impacted by the industry sector's share and the OEA's lag (Tables A5 and A6). This indicates that the positive lag effect of the OEA on economic development occurs in tandem with an increase in the industry sector's share of the economy. Industry sector expansion creates new business opportunities for entrepreneurs who have innovative ideas and products. For the subsample representing advanced economies, the relationship between the share of the industry sector and the NEA latency is negative. This implies that as the industry sector's share of the GDP rises, the NEA's impact on economic development decreases. It is peculiar that the NEA, which is typically represented by small-scale enterprises, and the industry sector, which typically requires substantial investments, have so little in common. The outcomes of the estimation in the absence of control variables are essentially equivalent to those acquired while controlling for variables. A substantial and positive correlation is observed between the lags of TEA and NEA and the proportion of the economy devoted to the manufacturing sector and economic development for the entire economy sample (Tables A7 and A8). Economic growth in emerging and developing economies is substantially and positively correlated with the manufacturing sector's share and the OEA's lag (Tables A7 and A8). Furthermore, Tables A7 and A8 illustrate a significant and positive correlation between the services sector, the NEA latency, and economic growth. This implies that economies boasting comparatively sizable services sectors experience a more pronounced positive impact on growth from NEA. A multitude of control variables exhibit statistical significance, and the signals they produce are consistent with the present research outcomes. Following each estimation, we applied the Chow test to ensure the robustness of our estimates pertaining to developed,

emerging, and developing economies. All of the results are statistically significant at the 1% level, as shown in Appendix Table A9. In addition, the correlations and summary statistics are presented in Table A4 and Table A3, respectively, of the appendix. Overall, our findings indicate that the expansion of services reinforces the advantages of NEA in developing countries, whereas the expansion of manufacturing magnifies the benefits of OEA.

Table 1:

Variables	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
(1) Gross domestic product (GDP) growth	1.00											
(2) GDP per capita growth	0.90	1.00										
(3) Total early-stage entrepreneurial activity rate	0.21	0.09	1.00									
(4) Opportunity-driven early-stage entrepreneurship activity	-0.08	-0.12	-0.16	1.00								
(5) Necessity-driven early-stage entrepreneurship activity	0.13	0.15	0.29	-0.68	1.00							
(6) Investment (% of GDP)	0.28	0.25	0.11	0.03	0.08	1.00						
(7) Population growth (annual %)	0.23	-0.20	0.34	0.11	-0.05	0.07	1.00					
(8) Education	-0.25	-0.10	-0.43	0.32	-0.47	0.01	-0.44	1.00				
(9) Economic openness (% of GDP)	0.02	0.04	-0.17	0.17	-0.21	0.02	-0.05	0.24	1.00			
(10) Industry value added	0.13	0.05	0.19	0.01	0.08	0.25	0.21	-0.05	-0.09	1.00		
(11) Manufacturing value added	0.03	0.13	-0.14	0.00	0.04	0.06	-0.21	0.04	0.00	0.37	1.00	
(12) Services value added	-0.28	-0.16	-0.37	0.21	-0.32	-0.21	-0.30	0.53	0.33	-0.61	-0.22	1.00

Source: Authors' calculation.

Summary:

Entrepreneurship, which entails the establishment and operation of a business, is vital to the growth and progress of the economy. Entrepreneurs promote innovation, which is important not only for dynamic Schumpeterian competition but also for overall economic vitality. This work contributes to the existing corpus of knowledge on entrepreneurship by examining the correlation between entrepreneurship and economic growth through the utilization of cross-section empirical research. We distinguish between necessity-driven early-stage entrepreneurship and opportunity-

driven early-stage entrepreneurship in order to account for the variability of entrepreneurship. In addition, the economies in our sample are categorized as either developed or developing. We find no evidence to support the notion that economic growth and overall entrepreneurship are positively correlated. This is logical in light of the extraordinarily varied nature of entrepreneurial activity. Furthermore, our empirical findings underscore the criticality of distinguishing between distinct types of entrepreneurship and economic sectors. More precisely, our research reveals a positive correlation between growth and opportunity-driven entrepreneurship in developing economies where manufacturing is relatively dominant. It is logical to conclude that substantial technological advancements in the manufacturing sector create numerous opportunities for innovative entrepreneurs, whereas the services industry's comparatively sluggish rate of technological progress necessitates a gradual adjustment by other entrepreneurs. In general, our research suggests that economic development and different types of entrepreneurship do not correlate in a statistically significant way. However, correlations do exist between growth and the interplay between sectoral shares and entrepreneurship as a whole. According to our findings, these types of effects might also be substantial enough to affect the economy. As an illustration, a standard deviation increase in the proportion of value-added by manufacturing in GDP and an increase in opportunity-driven entrepreneurship activity rate from the mean level of developing economies to the mean level of advanced economies are both correlated with a 0.41% annual growth in GDP per capita or a 4.1% annual growth rate over a decade.

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