Chapter 2
Entrepreneurial Motivations, Culture, and the Law

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Abstract Inspired by Schumpeter’s seminal depiction of the entrepreneur, this chapter recasts this heroic portrait in a more rigorous theoretical framework, leveraging a model of individual value preferences by Schwartz. The entrepreneurial spirit, it is argued, consists of particular value preferences: most importantly high openness-to-change and also high self-enhancement. These hypotheses are consistent with extant empirical evidence. The upshot of this theory – especially when the stability of cultural value orientations is taken into account – is that individual propensities to engage in new venture creation may not be very susceptible to policy measures. Looking specifically at legal measures, this chapter considers measures that could be narrowly targeted to promoting entrepreneurship by making entrepreneurs even more highly motivated than what they appear to be. Recent research indicates, however, that theoretical and empirical issues, which must be resolved before such measures could be employed with confidence, are intractable at this point.

1 Introduction

Fostering entrepreneurship has become a central policy goal for economic institutions around the world, ranging from regional to national to international bodies. Underlying this trend is the belief that entrepreneurship is key for a number of desirable social outcomes, including economic growth, lower unemployment, and technological modernization.1 This chapter therefore asks a simple and at the same

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time crucial question: What makes some people more entrepreneurial than others? A companion question follows almost immediately: Can policy makers do something to promote entrepreneurship?

To answer these questions, this chapter returns to Schumpeter’s (1912/1934) Theory of Economic Development. I argue that Schumpeter was right when he described entrepreneurs as special people. While there are several economic accounts of the functions entrepreneurs fulfill in the economy, Schumpeter’s account remains most insightful in capturing the essential qualities that distinguish entrepreneurs from others in society. The central goal of this chapter is to recast Schumpeter’s depiction of the entrepreneur in modern economic and psychological terms. A sizable body of literature has examined some psychological traits of entrepreneurs. The greatest amount of attention has been paid to entrepreneurs’ attitudes towards risk and to their need for achievement. Work has also been done on entrepreneurial perception. In comparison, the motivational goals that guide entrepreneurs as they choose an entrepreneurial course of action have been relatively neglected. These motivational goals, or value preferences, constitute the “entrepreneurial spirit.”

This chapter hypothesizes that beyond seeking material success the crucial element in the entrepreneurial spirit is openness to change – an interest in the different and in new experiences while deemphasizing the safe and the proven. (I also briefly explore entrepreneurs’ cognitive style). What makes entrepreneurs special is their attitude toward uncertainty more than toward simple risk. Thus depicted, the Schumpeterian portrait of the entrepreneur is not entirely consistent with the standard depiction of economic actors in neo-classical economics. Yet this portrait is truer to reality. It can thus help us understand the cultural and legal institutions that bear on entrepreneurship.

The chapter proceeds as follows. Section “Portraits of the Entrepreneur” surveys the literature on the nature and characteristics of the entrepreneur from two perspectives: economic and psychological. In particular, this section tries to glean the literature’s view on whether entrepreneurs are special individuals or rather ordinary people channeled by circumstances to engage in new venture creation. Section “Entrepreneurial Motivations” addresses the first part of this chapter’s title by putting forward a small theory on entrepreneurial motivations and arguing that these motivations constitute the entrepreneurial spirit. Entrepreneurial motivations are claimed to stem from particular individual value preferences according to a theoretical model developed by psychologist Shalom Schwartz. Based on this model, this section then derives testable hypotheses, with which Schumpeter’s seminal account of the entrepreneur is highly consistent. Section “The Cultural Context” briefly discusses the cultural context of entrepreneurship, primarily to underscore the stability of informal social institutions. Section “Can Legal Measures Foster Entrepreneurship?” addresses the latter part of this chapter’s title: Can law help in fostering entrepreneurship? After briefly discussing the importance and (un)likelihood of improving the general legal infrastructure, I address legal measures that regulate the birth of a new venture (i.e., entry) and its death (i.e., bankruptcy). In both cases, it appears, there is disappointingly little room
for effective intervention targeted at fostering entrepreneurship. The last section concludes here.

2 Portraits of the Entrepreneur

2.1 Defining Entrepreneurship

A well-known problem in the study field of entrepreneurship is the lack of an agreed definition for this concept. This has led to considerable disarray in the literature. In particular, it is unclear whether innovation is a necessary element for entrepreneurship, or does self-employment suffice, or whether self-employment and ownership of a small business firm are equally entrepreneurial (see Ulijn and Brown 2003). The etymology of “entrepreneurship” derives from French and German words for “undertaking” (entreprendre, unternehmen, respectively). Yet the linguistic exercise does not convey the full meaning of being an entrepreneur.

A good definition of entrepreneurship should consider the role of the entrepreneur in the economy. However, the question “what is entrepreneurship?” is usually answered by stating “what entrepreneurs do,” which oftentimes transforms into “what entrepreneurs like.” The following describes three major roles for entrepreneurs that the economic literature has recognized and the types of persons who would perform these roles. I then briefly consider more recent discussions of characteristic features of entrepreneurs. Next, I review some personal psychological traits that have been associated with individuals’ tendency toward entrepreneurship.

2.2 The Entrepreneur in Economics

In the standard neo-classical economics of the late nineteenth century, things don’t change in the general equilibrium. There is no room for entrepreneurship. Prominent economists from the eighteenth and nineteenth centuries, including Cantillon, Smith, and Say, have nonetheless recognized the pivotal role of entrepreneurship in the economy as the source of change, development, and progress (see van Praag (1999); Herbert and Link (1989); Gartner (1990); Kao (1993)).

Schumpeter continued the work of Cantillon by developing a theory of economic development as a dynamic process of change. The entrepreneur in the Schumpeterian scheme brings about the famous “constructive destruction” by finding new combinations for production. The entrepreneur differs from other providers of resources such as land, financial capital, labor, and even from inventors who provide patents. The entrepreneur’s main function is to overcome the difficulties engendered by uncertainty (Schumpeter 1928). A central premise in Schumpeter’s
theory (Schumpeter 1951, p. 248) – which is the focus of this chapter – is that
entrepreneurs have special skills for innovation and for dealing with uncertainty.
Knight (1921) provided sound theoretical underpinnings to previous observa-
tions about the unique role entrepreneurs have in addressing uncertainty. Relative
to the average person, the entrepreneur is particularly “venturesome,” self-confident,
and tends to act independently on her own opinion (Knight 1921, p. 269). Kirzner’s
(1973, 1997) entrepreneur resembles Schumpeter’s in that both are agents of
change in the economy. Kirzner’s entrepreneur operates primarily as a gaps-closing
arbitrageur, however, while Schumpeter’s archetypal entrepreneur innovates and
creates (Kirzner 1999). In Lazear’s (2004, 2005) theory too, the entrepreneur
differs from most other people in the population. Counter-intuitively, however,
what makes him special is that he doesn’t excel in anything in particular. He is
“Jack-of-all-trades.” Lazear and others have shown that entrepreneurs have a more
varied curriculum as students and tend to work in a greater number of jobs (Lazear
tend to have a broader experience, the choice to become an entrepreneur is driven
by unobservable factors. Ästebro (2006) argues that entrepreneurs have a “taste for
variety.” Santarelli and Vivarelli (2006), in a discussion of this literature, conclude
that the reason may be ex-ante innate characteristics.2

The economic literature has not delved specifically into such “taste for variety.”
However, two other personal traits of entrepreneurs have attracted some attention,
namely, a preference for non-pecuniary rewards and, more specifically, a prefer-
ence for autonomy (Hamilton 2000; Moskowitz and Vissing-Jørgensen 2002;
argue that in essence, entrepreneurship is a non-profit-seeking activity. According
to Benz, entrepreneurs derive non-monetary benefits from engaging in entre-
preneurship, primary among which is greater autonomy.2 Benz’s theory there-
fore rationalizes behavioral patterns of entrepreneurs that otherwise could have
been dubbed – and likely dismissed – as irrational. In a similar vein, another
common observation about entrepreneurs concerns their seeming over-optimism
(Arabshehini et al. 2000; Bernardo and Welch 2001; Cooper et al. 1988).

2.3 Psychological Analyses of Entrepreneurial Attributes

The notion, that entrepreneurs may have special personal attributes in comparison
to the general population, hasn’t gone unnoticed among psychologists. The litera-
ture on this subject is broad but quite unorganized, such that surveying it in full is
well beyond the scope of the present chapter (see Shook et al. 2003; Krueger 2003
for surveys). Gartner (1988) argued that entrepreneurship research should not focus

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2 See also Blanchflower and Oswald (1998); Blanchflower (2000); Kawaguchi (2004); Beugelsdijk
and Noorderhaven (2005); van Gelderen et al. (2003); van Gelderen et al. (2006).
on entrepreneurs’ individual personality but rather on entrepreneurial action (i.e.,
venture creation), which is more socially contextual. Yet the quest for a psycholog-
ical profile of the entrepreneur continues. The little agreement that used to exist
until recently in this respect was that such personal attributes have not yet been
identified. Shook et al. (2003, p. 382) thus concluded that “[t]he search for an
entrepreneurial personality profile was largely unsuccessful.” In recent years,
however, psychologists have been revisiting the empirical literature with the tool
of meta-analysis such that clearer patterns are beginning to emerge.

In general, the attributes and themes studied by psychologists reflect the special
qualities and roles that economists have attributed to entrepreneurs. Early work
looked at three major psychological constructs that appear consistent with an
“entrepreneurial personality,” namely, high need for achievement, internal locus
of control, and a risk-taking propensity (Korunka et al. 2003).

Need for achievement was defined by McClelland (1961) as a motivation to
excel in attaining goals in competitive settings through hard work, self-challenging,
and persistence. Entrepreneurs may have an image of high-achievers, yet studies
show that entrepreneurs do not stand out significantly in terms of their need for
achievement. Non-entrepreneurs can be equally achievement-seekers at times and
entrepreneurs may not exhibit a stable high need for achievement (Rauch and Frese
2000). A recent meta-analysis of the relationship of achievement motivations to
entrepreneurial behavior nonetheless finds a positive correlation between the for-
mer and the choice of an entrepreneurial career and entrepreneurial performance
(Collins et al. 2004). Having an internal locus of control – a personality factor
reflecting a belief that one can influence the outcomes of one’s life (Rotter 1966) –
has also been related to an entrepreneurial personality. The extant evidence is
mixed, leading Rauch and Frese (2000) to conclude that there seems to be other
variables moderating the relationship between internal locus of control and becom-
ing a small business owner.

In line with the common depiction of entrepreneurs as risk-bearers, the corollary
has been that less risk averse individuals will become entrepreneurs, while the more
risk averse will prefer wage income (Kihlstrom and Laffont 1979; van Praag and
Cramer 2001). A pioneering empirical study by Brockhaus (1980) failed to find
support for a link between entrepreneurial action and risk-taking propensity, how-
ever. The received wisdom about such link subsequently thus was that it has not
been established empirically. Evidence about entrepreneurs’ higher risk propensity
continues to accumulate, however. For instance, interim results from large surveys
directed by economists in Russia and China, albeit without a psychological theo-
retical framework, indicate such high propensity (Djankov et al. 2005, 2006).

In a meta-analysis of risk propensity differences between entrepreneurs and
managers, Stewart and Roth (2001) conclude that the literature as a whole in fact
suggests that entrepreneurs do have a somewhat higher risk propensity than man-
gers. Moreover, when a distinction is made between income-oriented and growth-
oriented entrepreneurs – i.e., small business owners interested mostly in producing
family income versus firm owners interested in profit and growth, respectively –
the latter entrepreneurs exhibit a markedly higher risk propensity. While the
clarification of the empirical results is commendable, it should be emphasized that
the theory of entrepreneurship revolves around Knightian uncertainty, not around
risk. More work is needed empirically to test this proposition, for which the
currently available evidence is only indirectly relevant.

There are numerous additional studies examining possible links between psy-
chological variables and entrepreneurial personal qualities. Of these, two factors in
particular may be mentioned: personality traits and cognitive factors. Traits are
dimensions of individual differences in tendencies to show consistent patterns of
thoughts, feelings and actions (McCrae and Costa 1990, 1997). Psychologists use
the five-factor model (FFM, or “Big Five model”) as the dominant approach for
representing the human trait structure (McCrae and John 1992). The model asserts
that five basic factors describe most personality traits: openness to experience,
extroversion, agreeableness, conscientiousness, and neuroticism.

Researchers have used the Big Five model to predict individual differences in
entrepreneurial attributes. Comparing entrepreneurs to managers, Zhao and Seibert
(2006) find that entrepreneurs score higher on conscientiousness and openness to
experience, and lower on neuroticism and agreeableness. These finding are in line
with the findings on entrepreneurs’ risk propensity. Although there is no known
direct link from personality traits to entrepreneurial action, the findings suggest that
individuals with this personality profile may be more attracted to engaging in
entrepreneurship and may find this more satisfying than others do and/or relative
to other occupations. Individuals with such personality traits may also be more
successful in mobilizing support for their entrepreneurial venture from capital
providers, employees, etc.

Kirzner’s theory of entrepreneurship postulates that alertness is the special
quality distinguishing entrepreneurs from most others. Stevenson and Jarillo
(1990), among others, define that entrepreneurship as an orientation toward oppor-
tunity recognition. These views point to the importance of entrepreneurs’ cognitive
facilities, including perception, memory, information processing, and decision
making. Entrepreneurs arguably excel in cross-linking and rearranging information
in ways that lead them to new projects. Research on these variables among
entrepreneurs – what may be called “entrepreneurial cognition” – is still devel-
oping. Some researchers question the fruitfulness of this line of research (Alvarez
and Barney 2006). Work by others, however, suggests ways for progress. Baron
(2006) argues that entrepreneurial opportunity recognition may be analyzed as a
specific case of pattern recognition – of “connecting the dots.” Baron 2000; Baron
and Ensley 2006; see also Gaglio 2004) further argues that entrepreneurs are less
likely to engage in counterfactual thinking; when they see a pattern they stick to it.

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3There is some controversy whether risk propensity is a specific combination of trait positions on
the FFM or an additional, sixth, dimension of personality traits. See Zhao and Seibert (2006).
4For reviews, see Wadeson (2006); Krueger (2003); Mitchell et al. (2007); see also Gaglio and
If true, this particular cognitive style may allow entrepreneurs to come up with new ideas and at the same time to avoid procrastinating about them for too long.

To recap, research on the individual psychology of the entrepreneur after 2 decades is beginning to yield a clear portrait, the features of which are well-anchored in rigorous analysis. Entrepreneurs are indeed special individuals in that they tend to exhibit a particular combination of psychological attributes compatible with their role in the economy as new venture creators. Needless to say, this does not mean that all entrepreneurs exhibit these attributes equally strongly during their entire career. Nor does this proposition deny the importance of the social context in which potential entrepreneurs emerge and operate. Finally, the focus herewith has been on individual psychological attributes. Proclivity toward entrepreneurship at the firm level – known as “Entrepreneurial Orientation” – raises additional issues not discussed here (see Lumpkin and Dess 1996, 2001).

3 Entrepreneurial Motivations

3.1 The Theoretical Challenge

A comparison of the economic and psychological accounts of entrepreneurial attributes points to a peculiar discrepancy. Economists at a very early stage recognized that entrepreneurs might be driven toward new venture creation by more than a simple desire for wealth attainment. In economics, wealth attainment is a standard proxy for self-utility maximization, which, in turn, is commonly used as a first-cut approximation for rational preferences. One can therefore immediately see that postulating “autonomy”, “independence”, or “variety” as goals that entrepreneurs pursue in fact challenges basic precepts of neo-classical economics. Absent a general theory of motivations, however, simply assuming that autonomy, or other factors, operate as arguments in people’s utility functions would lead to tautology.

The budding literature on non-pecuniary motivations indicates that economic analysis of entrepreneurial motivations may lead to a more fundamental rethinking of economic theory. As the following section shows, however, Schumpeter had already foreseen both the need to account for non-pecuniary motivations and the fundamental challenge they pose to economic theory. Against this backdrop, one may note with surprise the paucity of psychological studies on entrepreneurial motivations.

Schumpeter (1934, p. 78) points out that “being an entrepreneur is not a profession and as a rule is not a lasting condition; . . . everyone is an entrepreneur only when he actually ‘carries out new combinations’ and loses that character as soon as he has built up his business, when he settles down to running it as other people run their business.”
While the survey in the preceding part cannot possibly be exhaustive, it covers
the major psychological factors discussed in the entrepreneurship literature. The
issue of entrepreneurs’ motivational goals has been virtually neglected. One strand
of the literature – namely, the studies dealing with entrepreneurs’ need for achieve-
ment – comes close to addressing this subject. Other variables – such as personality
traits, risk propensity, etc. – may correlate partially with motivational goals but they
are conceptually different.

The upshot is that a central feature in the economic analysis of entrepreneurial
behavior lacks moorings in psychology. Economists thus find themselves making
behavioral propositions, which, notwithstanding their plausibility, are detached
from behavioral scientific analysis. In this situation, deriving normative prescrip-
tions – and in particular, recommending legal reform with a view to fostering
entrepreneurship – would be questionable at best. This part therefore presents a
small theory of entrepreneurial motivations that integrates current psychological
theory with Schumpeter’s classic economic insights.

### 3.2 Entrepreneurial Values

To generalize from the literature surveyed above, the debate over the nature of the
entrepreneur essentially asks whether entrepreneurs are special individuals or is
anyone, under certain conditions, equally likely to be an entrepreneur. In the
context of motivations, this debate thus suggests our first hypothesis: People who
become entrepreneurs have a particular set of motivational goals. Stated otherwise,
entrepreneurs stand out in term of the issues that they consider important and worth
pursuing in life. The null hypothesis therefore is that entrepreneurs’ goals are not
significantly different from the goals of the general population.

As already noted, there is evidence, gathered mostly by economists, that entre-
preneurs seek autonomy more than wealth attainment. Some preliminary evidence
suggests that they also seek variety. However, deriving a general hypothesis from
these sporadic observations requires first a general theory of motivational goals.
To this end, I use Schwartz’s (1992) theory on individual-level value preferences.
Values are defined as conceptions of the desirable that guide the way individuals
select actions, evaluate people and events, and explain or justify their actions and
evaluations. In this view, values are trans-situational criteria or goals (e.g., security,
wealth, justice), ordered by importance as guiding principles in life. Values are not
objective, cold ideas. Rather, when values are activated, they become infused
with feeling. The trans-situational nature of values means that values transcend
specific actions and contexts. Obedience, for example, is relevant at work or in

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*For the present study, I have conducted searches in both JSTOR and Econlit databases and
extensive, though obviously not comprehensive, searches of internet resources. A study that bears
directly on this subject and is discussed in more detail below is Fagenson (1993).*
school, in sports or in business, with family, friends or strangers (Rokeach 1973; Schwartz 1992).

Milton Rokeach (1973) provided a clear definition of values as guiding principles in life and proposed a list of values that was meant to be universal and comprehensive. Schwartz and Bilsky (1987) analyzed cross-national data based on a survey instrument developed by Rokeach and confirmed the existence of certain value types in each country. Schwartz (1992, 1994) advanced a comprehensive model of individual-level values that represent universal requirements of human existence (biological needs, coordination of social interaction, group functioning) as motivational goals. Schwartz extended the Rokeach value inventory with values drawn from other cultures, including Asian and African ones. Table 1 provides definitions of the ten values types distinguished by Schwartz and value items that reflect them.

An interesting feature of the Schwartz model is the structural interrelations among value types. These value types can be drawn as segments of a circle. Figure 1 depicts this spatial arrangement. Adjacent value types are conceptually close to one another whereas opposing value types express conceptually diametrical goals in life. Thus, individuals who put a high emphasis on values of universalism (social justice, equality) would also tend to emphasize benevolence values (helpful, honest, etc.). People who emphasize universalism and benevolence would tend to de-emphasize values that belong to opposing value types (e.g., achievement versus benevolence).

The ten value types distinguished by Schwartz are organized along two bipolar orthogonal dimensions. These dimensions reflect a higher level of conceptual commonality among value types. One dimension, entitled self-enhancement versus

Table 1 The Schwartz individual values and representative items

<table>
<thead>
<tr>
<th>Value Type</th>
<th>Representative Items</th>
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<tbody>
<tr>
<td>Self-Direction</td>
<td>Independent thought and action-choosing, creating, exploring (creativity, freedom, independent, curious, choosing own goals)</td>
</tr>
<tr>
<td>Stimulation</td>
<td>Excitement, novelty, and challenge in life (daring, a varied life, an exciting life)</td>
</tr>
<tr>
<td>Hedonism</td>
<td>Pleasure and sensuous gratification for oneself (pleasure, enjoying life)</td>
</tr>
<tr>
<td>Achievement</td>
<td>Personal success through demonstrating competence according to social standards (successful, capable, ambitious, influential)</td>
</tr>
<tr>
<td>Power</td>
<td>Social status and prestige, control or dominance over people and resources (social power, authority, wealth)</td>
</tr>
<tr>
<td>Security</td>
<td>Safety, harmony and stability of society, of relationships and of self (family security, national security, social order, clean, reciprocation of favors)</td>
</tr>
<tr>
<td>Conformity</td>
<td>Restraint of actions, inclinations and impulses likely to upset or harm others and violate social expectations or norms (self-discipline, obedient, politeness, honoring parents and elders)</td>
</tr>
<tr>
<td>Tradition</td>
<td>Respect, commitment and acceptance of the customs and ideas that traditional culture or religion provide (accepting my portion in life, humble, devout, respect for tradition, moderate)</td>
</tr>
<tr>
<td>Benevolence</td>
<td>Preservation and enhancement of the welfare of people whom one is in frequent personal contact (helpful, honest, forgiving, loyal, responsible)</td>
</tr>
<tr>
<td>Universalism</td>
<td>Understanding, appreciation, tolerance and protection for the welfare of all people and for nature (broadminded, wisdom, social justice, equality, a world at peace, a world of beauty, unity with nature, protecting the environment)</td>
</tr>
</tbody>
</table>
self-transcendence, opposes power and achievement values to universalism and benevolence values. The dimension of openness to change versus conservation opposes self-direction and stimulation to security, conformity, and tradition values. Hedonism values share elements of both openness to change and self-enhancement. The Schwartz model thus provides a nearly universal description of the content and structural relations of human values at the individual level (Rohan 2000; see also Bilsky and Koch 2002). Values have been conceptualized as the core of one’s personal identity (Hitlin 2003). Value priorities in this model relate systematically with personality traits under the Big Five model (Roccas et al. 2002). Value priorities furthermore have been linked to behavior in a number of studies (Bardi and Schwartz 2003; Barnea and Schwartz 1998; Caprara et al. 2006). The path from values to behavior is not direct and involves mediating factors, however (e.g., Verplanken and Holland 2002).

From an economic analysis perspective, the Schwartz theory provides a comprehensive model of human motivations. Representing the set of conceptions of the desirable, the distinct ten values can be seen as ten distinct arguments in individuals’ utility functions. This theory thus may help in advancing the debate over the meaning of rationality among law and economics scholars that took place at the turn of the century. In particular, by providing a framework for generating and testing falsifiable hypotheses, this theory may help in meaningfully integrating
non-material, non-self-utility into economic analysis. It deserves emphasizing, however, that between the two value dimensions, openness-to-change versus con-
servation and self-enhancement versus self-transcendence, the former is more
foreign to standard economic theory.

Consider self-enhancement versus self-transcendence. Not until too long ago, a
debate was raging whether “economic man” – i.e., the expected-self-utility maxi-
mizer – provides a satisfactory model for economic actors. This debate is largely
over (Camerer and Fehr 2006; Rabin 2002). A large body of evidence shows that
people may incur substantial costs systematically to promote other people’s inter-
est or just “to make a point.” In such cases, the self-utility that may accrue to the
actor is affected by the utility accruing to others. Stated otherwise, people regularly
care about others in the society. Hence the terms “social preferences” and “other-
regarding preferences” to describe such motivations. The current debate in eco-
nomics revolves around the precise content of such other-regarding preferences,
namely, the ways in which actors incorporate others’ utility into their own utility
function (e.g., Fehr and Schmidt 1999; Charness and Rabin 2002).

Within the Schwartz model, self-regarding and other-regarding preferences map
onto the self-enhancement versus self-transcendence dimension, respectively. Self-
regarding preferences comprise seeking pure pleasure to oneself, which corre-
sponds with hedonism values, as well as other forms of attaining utility, both
material and non-material, which is partially covered by achievement values. On
the opposite pole of this dimension, altruistic preferences directed to particular
others are conceptually compatible with benevolence values. More open-ended
other-regarding preferences, postulated mainly by Charness and Rabin, are con-
ceptually compatible with Schwartz’s universalism value.

The motivations covered by the openness-to-change versus conservation dimen-
sion are relatively less developed in economics. Theoretical work addressing the
Ellsberg Paradox (Ellsberg 1961) indicates that people have an ambiguity aversion,
or Knightian uncertainty aversion (distinguished from risk aversion) (Segal 1987;
Halevy 2007). That is, when asked to choose among risky outcomes, people ascribe
lower utilities to outcomes about which they don’t know the probability of risk
levels. Empirical studies strongly confirm the existence of ambiguity aversion
(Halevy 2007). This type of preference is conceptually compatible with high
priority on conservation values, while lower ambiguity aversion is compatible
with openness-to-change. Elsewhere I argued that from a cognitive point of view,
uncertainty, ambiguity, and complexity are linked because they entail a higher
cognitive load. Individual priorities on the conservation versus openness-to-change
dimension further relate to different psychological constructs of cognitive style
(Licht 2004). Specifically, a higher need for cognitive closure is conceptually
related to greater emphasis on conservation and vice versa. The emphasis on

7 “Other-regarding preferences” is a more accurate term than “social preferences” because the latter might mistakenly connote group preferences.
8 On motivated cognition, see Jost et al. (2003).
preserving the status quo – whether real or an imaginary ideal thereof (consider
“family values”) – is especially clear in such value items as respect for tradition,
honoring parents and elders, and social order. The preference for certainty and
stability over ambiguity and change is also reflected in seemingly innocuous value
items like cleanliness that convey a sense of clarity.

Within this theoretical framework, several hypotheses can now be derived about
individuals’ value priorities as representations of their motivational goals and their
proclivity to engage in entrepreneurship.

First, at a high level of generality, entrepreneurs would score higher on open-
ness-to-change values than on conservation values. The role ascribed to entrepre-
eurs in economic theory is that of agents of change. Whether thanks to greater
uncertainty tolerance a la Knight, or to an urge for seeking new combinations a la
Schumpeter, or to their superior alertness to new information a la Kirzner, entre-
preneurs are expected to feel more comfortable with changing circumstances.
Relative to the general population, entrepreneurs are expected to ascribe lower
desirability to keeping with the “tried, tested and true,” to following what their
bosses or elders tell them to do, etc. (the latter reflecting higher priority for
conservation values). More specifically, one should expect to see entrepreneurs
giving especially high priority to self-direction (reflected, e.g., in being indepen-
dent, curious, creative, and able to choose one’s own goals) and also to stimulation
(reflected, e.g., in being daring and in having a varied life).

Second, entrepreneurs would score higher on self-enhancement values than on
self-transcendence values. This hypothesis might seem somewhat less novel than
the preceding hypothesis because a central value in self-enhancement is achieve-
ment. Schwartz (1992) defines the achievement value as “personal success through
demonstrating competence according to social standards.” This definition is close
to McClelland’s definition of the need for achievement motive. McClelland’s need
for achievement construct furthermore has been theoretically and empirically
linked to the Schwartz achievement value (Bilsky and Schwartz 2006). Thus, we
would expect entrepreneurs more than others to consider personal success as a
central goal in their life. The Schwartz model predicts that concomitantly with the
greater emphasis on personal success, entrepreneurs will ascribe lesser importance
to benevolence and universalism values, which constitute the self-transcendence
pole. Entrepreneurs will thus be relatively less inclined to endorse other-regarding
preferences.

To my knowledge, no study has investigated entrepreneurs’ value preferences in
the Schwartz framework.9 Only a handful of researchers have drawn on Rokeach’s
theory to posit a link between individual value preferences and a proclivity to
entrepreneurship. Rokeach postulated a distinction between terminal and instru-
mental values, where the former represent preferred end-states of being or global
goals in life, while the latter represent preferred modes of conduct toward such

9Several studies attempted linking values with entrepreneurship but they suffer from serious
methodological weaknesses. For a critical survey see Bird and Brush (2003).
end-states. Surveying the literature as of 1989, Barbara Bird hypothesized, based on
the Rokeach theory, that entrepreneurs would have a preference for autonomy and
independence as instrumental values (cited in Bird and Candida 2003). Bird further
conjectured that entrepreneurs’ terminal value priorities would emphasize fame,
status and power, and that they may consider money primarily as a way of keeping
score in an achievement “game.”

Fagenson (1993) reported results from the only theory-driven study of differ-
ences in value priorities among US managers and entrepreneurs, using the Rokeach
framework. Entrepreneurs scored significantly higher on terminal values of self-
respect, freedom, a sense of accomplishment, and an exciting life, and also on
instrumental values of being honest, ambitious, capable, independent, courageous,
imaginative, and logical. Managers scored significantly higher than entrepreneurs
on terminal values of true friendship, wisdom, salvation, and pleasure, and
on instrumental values of loving, compassionate, forgiving, helpful, and self-
controlled. The Schwartz model does not support Rokeach’s instrumental/terminal
values distinction. However, the Schwartz Values Survey, which was used to
confirm the model, includes many value items from the Rokeach Values Survey.
Mapping the Rokeach items onto the Schwartz values and higher-level value
dimensions indicates that Fagenson’s findings are consistent with the hypothesis
advanced above. Specifically, entrepreneurs scores higher than managers on items
that reflect stimulation, self-direction, and achievement in the Schwartz model.

The evidence gathered by economists lends further support the above hypoth-
eses. Recall the studies mentioned above that demonstrate entrepreneurs’ prefer-
ence for autonomy. Although lacking in theoretical underpinning, the evidence,
showing that entrepreneurs prefer to be their own bosses, that they like to be
independent, and so forth, is consistent with higher priority on self-direction. The
evidence on a preference for variety, which Santarelli and Vivarelli (2006) take to
be an ex-ante innate characteristic, likewise is consistent with higher openness to
change. Similarly, with regard to Lazear’s (2005) model, the Schwartz model
provides a motivational theory on why some people happen to be “Jacks of all
trades,” happen to pursue studies in several fields as well as several careers, etc.,
and maybe more likely to succeed as entrepreneurs as a consequence. The
(hypothesized) reason is that they have a particular value preference profile.

3.3 Schumpeter Revisited

Although hardly neglected, Schumpeter’s theory of the entrepreneurial spirit
remains under-appreciated, or at least under-utilized, for informing current theore-
tical accounts. This section revisits Schumpeter’s account of the entrepreneur and
demonstrates that it is highly compatible with the theory of entrepreneurial motiva-
tions advanced above. The theory of entrepreneurial motivations thus recasts
Schumpeter’s theory in a rigorous analytical framework that renders the latter
susceptible to empirical investigation.
Among the theories of the economic role of the entrepreneur, Schumpeter’s theory stands out as the most comprehensive. As noted above, Knight’s theory of the entrepreneur as a bearer of uncertainty may be subsumed into Schumpeter’s theory. Kirzner himself, in recent writings, pointed to the consistency between his theory and Schumpeter’s theory in regards with alertness to new combinations of information. Lazear’s theory is devoid of reference to motivation but is nonetheless premised on combinations of skills and experiences that lead one to pursue new venture creation.

Writing nearly a century ago, Schumpeter’s account remains insightful, rich, and vivid. It would be a mistake to take it as romantic. Schumpeter likely appreciated the entrepreneurial type (“our type,” in his words). Yet the attributes he ascribed to the entrepreneur were not merely romantic embellishments. These attributes derive from his analysis of entrepreneurs’ role in the economy. Even today, Schumpeter’s analysis is so sharp that to the extent possible, the following section draws on his own words for the presentation of his arguments. I limit myself to providing headlines and to suggesting some interpretation.

- It’s the motivations, . . .

Schumpeter had identified the weak points in the standard economic account of economic agents. These lifeless agents could not bring about economic change and development. Schumpeter (1934, p. 90) thus saw the crux of being an entrepreneur as having an unusual set of motivations.

We shall finally try to round off our picture of the entrepreneur in the same manner in which we always, in science as well as in practical life, try to understand human behavior, viz. by analysing the characteristic motives of his conduct.

- Psychology can inform economic analysis.

In order to develop a decent account of entrepreneurial motivations economists may draw on psychology. Schumpeter was thus reflecting an interdisciplinary mode (and mood) of analysis, which had had more currency but later on went out of fashion (see Lewin 1996). In an effort to preempt objections from advocates of the strict “revealed preferences” approach, Schumpeter (1934, p. 90) nevertheless emphasizes that his theory is testable even by the standards of revealed preferences.

Any attempt to [analyze the motives of entrepreneurs’ conduct] must of course meet with all those objections against the economist’s intrusion into “psychology” which have been made familiar by a long series of writers. . . . [N]one of the results to which our analysis is intended to lead stands or falls with our “psychology of the entrepreneur,” or could be vitiated by any errors in it. Nowhere is there . . . any necessity for us to overstep the frontiers of observable behavior. Those who do not object to all psychology but only to the kind of psychology which we know from the

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10Schumpeter wrote the first edition of *The Theory of Economic Development* in 1911 and rewrote the text in 1926 for the second German edition, which appeared in English in 1934. Schumpeter (1934, p. ix).
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traditional textbook, will see that we do not adopt any part of the time-honored picture of the motivation of the “economic man.”

- Entrepreneurs are rational agents, but their self-utility stems from other sources.

Practicing what he was preaching, Schumpeter’s account of the entrepreneur and her motivational goals is a masterful demonstration of constructive destruction. Schumpeter (1934, p. 91) thus emphasizes that his theory belongs in the mainstream of economic analysis as it is premised on a conventional definition of rationality as self-utility maximization.

[O]ur type... he may indeed be called the most rational and the most egotistical of all... And the typical entrepreneur is more self-centred than other types, because he relies less than they do on tradition and connection and because his characteristic task - theoretically as well as historically - consists precisely in breaking up old, and creating new tradition...

However, it is impossible to analyze entrepreneurship if self-utility is limited to material consumption and sensuous gratification to oneself. Schumpeter (1934, p. 92–93) thus foreshadowed the current debate in economics over interpreting rationality.

But [the entrepreneur’s] conduct and his motive are “rational” in no other sense. And in no sense is his characteristic motivation of the hedonist kind. If we define hedonist motive of action as the wish to satisfy one’s wants, we may indeed make “wants” include any impulse whatsoever, just as we may define egoism so as to include all altruistic values too, on the strength of the fact that they also mean something in the way of self-gratification. But this would reduce our definition to tautology.

Hedonistically, therefore, the conduct which we usually observe in individuals of our type would be irrational. This would not, of course, prove the absence of hedonistic motive. Yet it points to another psychology of non-hedonist character, especially if we take into account the indifference to hedonist enjoyment which is often conspicuous in outstanding specimens of the type and which is not difficult to understand.

- Beyond Hedonism: Achievement and Power

Having clarified that a conventional, hedonistic self-utility cannot explain entrepreneurship, Schumpeter moves on to make his famous argument on entrepreneurial motivations. The motivations posited by Schumpeter (1934, p. 93) read like textbook descriptions of Schwartz’s self-enhancement values – achievement and power.

First of all, there is the dream and the will to found a private kingdom, usually, though not necessarily, also a dynasty... Its fascination is specially strong for people who have no other chance of achieving social distinction. The sensation of power and independence loses nothing by the fact that both are largely illusions... Then there is the will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself... And again we are faced with a motivation characteristically different from that of
“satisfaction of wants” in the sense defined above, or from, to put the same thing into other words, “hedonistic adaptation.”

- Beyond Hedonism: Self-Direction and Stimulation

The desire to demonstrate achievement and power (but mostly achievement) does not exhaust entrepreneurial motivations. Next, Schumpeter (1934, p. 93–94) turns to the more elusive motivations, those of openness-to-change in the Schwartz model - self-direction and stimulation.

Finally, there is the joy or creating, of getting things done, or simply of exercising one’s energy and ingenuity. This is akin to a ubiquitous motive, but nowhere else does it stand out as an independent factor of behavior with anything like the clearness with which it obtrudes itself in our case. Our type seeks out difficulties, changes in order to change, delights in ventures. This group of motives is the most distinctly anti-hedonist of the three.

4 The Cultural Context

This chapter focuses on entrepreneurial motivations as representations of the “entrepreneurial spirit.” The analysis therefore takes place at the individual level.

The literature, however, has noted the importance of the social context in which individuals engage in entrepreneurial action. Schumpeter (1934, p. 91) put forward this insight long ago in his discussion of the sources of economic motivations in general, again foreshadowing insights from modern economic sociology:

[We should] recognise that economic motive so defined varies in intensity very much in time; that it is society that shapes the particular desires we observe; that wants must be taken with reference to the group which the individual thinks of when deciding his course of action – the family or any other group, smaller or larger than the family; . . . that the field of individual choice is always, though in very different ways and to very different degrees, fenced in by social habits or conventions and the like.

Ample research indeed documents the importance of family background, prior education, social connections and networks, and so forth for effectuating entrepreneurial potential. In particular, social norms in individuals’ environment have been shown to affect their choice to become entrepreneurs even for a lower income (Giannetti and Simonov 2004).

At the highest level of social context, there is virtual consensus in the entrepreneurship literature that culture bears a profound impact on all facets of entrepreneurship in societies (see Hayton et al. 2002; Licht and Siegel 2006 for surveys). This literature almost invariably draws on a theory of cultural value dimensions

\[11\] See, e.g., Shane (2000); Saxenian (2002); Guiso and Schivardi (2005); Djankov et al. (2005, 2006); Gompers et al. (2005).
advanced by Hofstede (1980, 2001). These culture-level dimensions are conceptually different from individual-level value dimensions such as those from Schwartz discussed above. Without elaboration, extant literature seems to suggest that cultures exhibiting high individualism, high masculinity, low uncertainty avoidance, and low power distance in Hofstede’s model are more conducive to entrepreneurship. Much of this literature exhibits considerable methodological disarray, however (Licht and Siegel 2006). According to Hofstede (2001, p. 164), low uncertainty avoidance “implies a greater willingness to enter into unknown ventures.” Other studies are consistent with the idea that a climate of high uncertainty avoidance in large organizations pushes enterprising individuals to go out and create their own businesses (Hofstede et al. 2004; Wennekers et al. 2007). In a joint study with Siegel and Schwartz, using a culture-level value dimension model from Schwartz (1999, 2006), we link higher entrepreneurship levels with lower scores on harmony, a cultural orientation related to societal disapproval of assertive change and of venturing (Siegel et al. 2007a). This relation is observed using data from the Global Entrepreneurship Monitor (GEM) as well as data on firm-age-skewness or firm-employment-size-skewness (Alfaro and Charlton 2006).

The literature on the link between culture and entrepreneurship at the national level is still making its first steps. Because culture is a fundamental, deep-seated social institution, its influence on entrepreneurship flows through numerous causal channels. A central channel is individual value priorities. The cultural theories from Hofstede and Schwartz postulate that cultural orientations may significantly affect individual value priorities in the nation. These value priorities include the ones described above as defining the entrepreneurial spirit – namely, high achievement, self-direction, and stimulation. The propensity to engage in entrepreneurship – in other words, the intensity of entrepreneurial spirit – consequently may be affected by the surrounding culture. It is therefore possible to speak not only about entrepreneurial individuals but also about entrepreneurial nations. These are nations whose cultural profile reflects a lower emphasis on uncertainty avoidance or on harmony.

Against this backdrop, policy makers might wonder whether entrepreneurship can be taught? Some optimistic commentators believe that it can. According to Kuratko (2005), “the question of whether entrepreneurship can be taught is obsolete.” More level-headed economists point out that the contributions of Schumpeter, Knight, and Kirzner notwithstanding, economics’ “limited concept of uncertainty (mere probabilistic risk) sheds little light on how entrepreneurs make decisions in situations characterized by ambiguity regarding key decision variables” (Klein and Bullock 2006).

Granted, numerous technical aspects of engaging in entrepreneurial action can be taught. For instance, the government can provide information – in training centers, through educational programs, in internet websites, etc.- on such issues

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13 I assume for convenience, yet in line with the general literature, that each nation represents a single culture.
as different corporate forms and their relative advantages, regulatory requirements
for doing business in various industries, etc. This kind of training may be valuable
for entrepreneurs in that it would lower their learning costs (and transaction costs
more generally). Such training, however, has nothing to do with acquiring entrepre-
neurial inclinations, which, it is argued, stem from value priorities.

The mechanisms leading to value acquisition are believed to be effective mostly
at pre-adolescence age. These mechanisms are influenced by an individual’s par-
tenting and other life circumstance (Goodnow 1997). Studies thus have found
interrelations between parenting style, personality traits, entrepreneurial orient-
ation, and entrepreneurial career prospects among German subjects (Schmitt-
Rödermund and Vondracek 2002; Schmitt-Rödermund 2004). Cultural value
orientations are societies’ most basic equilibria on normative issues. Cultural
change in terms of significant shifts in value orientations likely takes place very
slowly, because of the nature of these orientations as equilibria, or in response to
major exogenous shocks. For this and for other reasons, culture is widely believed
to be relatively stable over long time periods (e.g., Roland 2004). The causal link
from cultural orientations to individual entrepreneurial value priorities con-
sequently would be stable as well and difficult to change. The upshot is that cultural
values may induce path dependence in entrepreneurial activity (Woodruff 1999).

Many studies indeed find continuity in a country’s proclivity for entrepreneurial
activity (Minniti et al. 2005). In one case, when the British government under
Margaret Thacher attempted to establish an “enterprise culture” in the United
Kingdom, the result was failure (Della Guista and King 2006).

5 Can Legal Measures Foster Entrepreneurship?

5.1 Law in Context

Legal measures are the primary tool in the hands of policy makers to engender
social change. Other than legal reform, the government can intervene with a view to
changing an existing equilibrium in the economy either through fiscal measures or
through engaging directly in business activities. (The latter practice has lost its
luster in most Western economies, however). In light of the theory – and recently,
also evidence – that entrepreneurship is pivotal in processes of economic growth,
the question arises whether legal measures could be used by policy makers to
promote entrepreneurship. This part explores this subject, first, on a general level
and, later, with regard to specific legislation that considers entrepreneurship from
the womb to the tomb – i.e., from setting up a business firm to bankruptcy.

A strict construction of the preceding analysis on the role of culture might
suggest that culture fully determines entrepreneurship in a society such that any
effort targeted to foster entrepreneurship would be doomed. Acs and Laszlo (2007),
in a recent special journal issue on entrepreneurship policy, thus conclude that
“government policy aimed at promoting entrepreneurship or influencing relevant factors cannot be effective in the short run, primarily because of cultural embeddings.” The present theory on entrepreneurial values elucidates why this may indeed be the case. The lesson for policy makers should be that measures aimed to fostering entrepreneurship probably should take the surrounding culture into account. At the current state of our knowledge, this is more easily said than done. Entrepreneurship-promotion programs, centers, and documents, prepared by academics and other commentators alike, are aplenty nonetheless. Policy recommendations that are being proposed in connection with promoting entrepreneurship are not significantly different than the standard reform packages that are intended to promote market economies in general. Acs and Laszlo’s (2007) account exemplifies the sweeping character that such policy recommendations could take. Their list includes trade policy, immigration policy, access to foreign technology, education, science and technology policy, and, finally, litigation and regulation. Baumol et al. (2007) offer a similarly broad program (see also Broadway and Jean-François 2005; Dixon et al. 2006). While there is no denying that all of the abovementioned issues may bear on entrepreneurship, for the most part they are not limited to entrepreneurship. These issues define economic policy in general – and sometimes much broader policies than economic alone (consider immigration policy) – such that “entrepreneurship” is merely a rallying cry for economic reform, warranted as it may be. Absent a preexisting political conviction, a general analysis of the different public policy measures that could be taken in connection with entrepreneurship is bound to yield ambiguous conclusions.

5.2 Improving Legality

Still on a general level of analysis, a broad consensus among economists holds that social institutions – in particular, “well-defined property rights” and the “rule of law” – are key for economic growth (e.g., Rodrik et al. 2004; Acemoglu and Johnson 2005). The former institution derives from basic welfare theory in economics. In order to enable welfare-enhancing transactions the subject matter of each transaction – who owns what – must be agreed between the parties in privy and also with all third parties. The latter institution, also called “legality”, refers to a set of norms and organizations that together lead to general compliance with formal legal rules. Extending this insight to entrepreneurship is straightforward. Boettke and Coyne (2003, p. 67) argue that “[t]he two most important ‘core’ institutions for encouraging entrepreneurship are well-defined property rights and the rule of law.” What is good for the economy in general is good for entrepreneurs.

14 This section draws on Licht and Siegel (2006).
15 It is therefore clear that the scope of “property rights” in this context is broader than the usual legal meaning and includes entitlements to obligatory rights such as debt.
Improving legality, runs the argument, will foster entrepreneurship (Baumol 1990; Harper 1998; Smith and Ueda 2006).

Extant evidence largely supports the above proposition. Examining the emergence of new firms in five former Soviet countries, Johnson et al. (1999, 2000, 2002) find that insecure property rights – defined as frequent need to make extralegal payments (bribes), protection, or inefficient courts – were more inhibiting to entrepreneurship than inadequate finance. Desai et al. (2003), using a measure that intertwines both formal delineation and actual protection of property rights, find that in the emerging markets of Europe, greater fairness and more property rights protection increase entry rates, reduce exit rates, and lower skewness in firm-size distribution. Theory and evidence are not limited to transition economies, however. Laeven and Woodruff (2007) find that in Mexico, states with more effective legal systems have larger firms, suggesting that a rule-of-law state enables entrepreneurial firms to grow by reducing idiosyncratic risk. Finally, Perotti and Volpin (2007) advance a political economy model and evidence suggesting that lack of political (democratic) accountability and economic inequality hinder entry through decreased investor protection.

The problem with policies intended to improve legality and other related social institutions such as absence of corruption, is that these institutions prove to be very stable. In particular, while these institutions exert a strong influence on a host of social outcomes, including economic development and infant mortality, recent contributions suggest that economic development feeds back to these institutions only weakly or not at all (Acemoglu et al. 2005; Kaufmann and Kraay 2002; Rigobon and Rodrik 2005). In collaborative studies with Schwartz, Siegel, and Goldschmidt, we show that these fundamental institutions, dubbed social norms of governance, are strongly affected by cultural orientations – a finding that helps explain the stability of these institutions (Licht et al. 2007; Siegel et al. 2007b). The upshot is that significant improvements in entrepreneurship levels through improvement in legality are unlikely to take place in the short run.

5.3 Targeted Legislation: Entry

An efficient way to promote entrepreneurship through legislation could be to eliminate unnecessary transaction costs. Suppose that in a particular country – say, Italy – an entrepreneur needs to follow 16 different procedures, pay nearly US$4,000 in fees, and wait some 62 business days for the necessary permits, while in another country, Canada, the same process on average takes two business days, requires only two procedures, and costs about US$280 in fees (Djankov et al. 2002). Few legal reforms look more straightforward than cutting down such superfluous red tape in Italy.

The link between entrepreneurship and regulatory costs of entry, measured by indicators of necessary steps, time, and money required for setting up a simple
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business firm, turns out to be more elusive, however. Ho and Wong (2007), using GEM data, distinguish three types of entrepreneurship: opportunity-driven (i.e., when entrepreneurs pursue a perceived business opportunity), necessity-driven (when other options for economic activity are lacking), and high-growth potential (when there are expectations for employment growth, market impact, globalization, and use of new technology). In very simple specifications, regulatory costs were found to be negatively linked only to opportunity entrepreneurship, especially in high-income countries. However, no significant link was found either to necessity-driven entrepreneurship and, more surprisingly, to high-growth potential entrepreneurship. Using a more nuanced empirical specification, André van Stel et al. (2007) find that these regulatory costs are unrelated to the formation rate of either nascent or young (opportunity-driven or necessity-driven) business firms. An exception is minimum capital requirements, which indeed have been criticized in the legal literature as redundant and overly burdensome in general (Enriques and Macey 2001).

More research is warranted beyond these preliminary findings. Van Stel et al. conjecture that their surprising result may be due to creative entrepreneurs who somehow find their way around the number of procedures or the amount of time that is required to start up a business. One may note that according to Djankov et al. countries with heavier regulation of entry have higher corruption, while countries with more democratic and limited governments have lighter regulation of entry. Klapper et al. (2006) document a correlation between more intensive entry regulation and lower firm growth as well as lower entry regulation in less corrupt countries. Regulatory entry barriers have no adverse effect on entry in corrupt countries, however. It may be the case that highly motivated entrepreneurs avoid the bureaucratic burden by paying bribes or simply by operating in the unofficial economy (black market). At the same time, in corrupt countries, entry into the official economy is already strongly deterred by systemic institutional weaknesses, including tax rates, corruption, greater incidence of mafia protection, and less faith in the court system (Johnson et al. 2000). The latter conjecture points again to the predominant role of culture in influencing social norms on corruption.

5.4 Targeted Legislation: Exit

Facilitating entrepreneurial activity directly through lower transaction costs of entry does not appear to be a promising strategy in light of currently available evidence. Perhaps, then, policy makers could encourage entry indirectly, by ameliorating entrepreneurs’ fear of economic loss – e.g., by making business failure less costly in bankruptcy proceedings. Recall, however, that entrepreneurs are already over-optimistic, above and beyond the level of over-optimism documented in the general population. In particular, financial loss does not deter determined entrepreneurs, who are not “in it for the money,” from engaging in new venture creation.
Mitigating the financial adversities of business failure therefore may or may not have the intended effect of increasing entrepreneurial activity.\footnote{Another potential adversity of bankruptcy is acquiring a social stigma of failure. I abstract from this aspect here. For a short discussion and further references, see Hahn (2006).} Much of the law and economics theory on bankruptcy has dealt with corporate bankruptcy. For the entrepreneur, however, the relevant bankruptcy in terms of her economic incentives is personal bankruptcy, in which she is called to satisfy her debts from her personal assets. The typical scenario of personal bankruptcy deals with consumers, such as those defaulting on their credit card debt or mortgage payments. Entrepreneurs may face personal bankruptcy proceedings if they operated through an unincorporated firm. In theory, establishing a firm – in most cases, a corporation of one sort or another – should entitle the entrepreneur \textit{qua} shareholder to shield her personal assets from the firm’s creditors thanks to the corporation’s separate legal personality and to her limited liability. In practice, proprietors of small businesses operating through a corporation are frequently required by their lender to provide collateral and/or personally guarantee the firm’s debts. Small entrepreneurs consequently face potential unlimited exposure to their firm’s liabilities.

By declaring bankruptcy the debtor may be able to get a “fresh start” if the bankruptcy court does not subject her future earnings to her past liabilities. This type of release is possible under Chap.\,7 of the US Federal Bankruptcy Code (11 U.S.C. §701 \textit{et seq}. 2007), which provides for “liquidation,” namely, the sale of a debtor’s nonexempt property and the distribution of the proceeds to creditors. Although personal bankruptcy procedures in the United States are primarily targeted for consumers such as those defaulting on their credit card debt or mortgage payments, entrepreneurs may take advantage of them as well. The Federal Code leaves room for state legislatures to exempt certain past assets from future liabilities, the most important of which is the homestead exemption.\footnote{There exists an alternative procedure to Chap.\,7 liquidation in Chap.\,13 of the Code. According to Berkowitz and White (2004, p. 71), “exemption levels are likely to have similar effects on credit markets regardless of the chapter that business owners would choose if they filed for bankruptcy.” Another alternative procedure exists when a debtor files for bankruptcy under Chap.\,11, which provides for reorganization. The debtor usually proposes a plan of reorganization to keep the business alive and pay creditors over time. Baird and Morrison (2005) have found that the vast majority of Chap.\,11 cases deal with small business entrepreneurs trying to extend the life of their business through these proceedings. Bankruptcy judges are aware of and guard against such efforts.}

The homestead exemption essentially creates a “wealth insurance” scheme for the debtor (Wei and White 2003). Even if the business failed, and even if the entrepreneur had to expose her personal wealth to such failure, the exemptions provide a sort of cushion to soften the fall. This insight has led academics recently to advocate a more entrepreneur-friendly bankruptcy law to encourage more vibrant entrepreneurship activity (Lee et al. 2007; Baumol et al. 2007). Hahn (2006) tellingly dubbed his proposal for a swifter, more forgiving discharge in bankruptcy “velvet bankruptcy.”
Such exemptions—and leniency in bankruptcy in general—is a double-edged sword, however. On the one hand, the wealth insurance may promote entrepreneurial initiatives as it ameliorates the entrepreneur’s fear of losing her home. On the other hand, like any other insurance, this exemption may create a moral hazard problem vis-à-vis the entrepreneur’s lenders, thus exacerbating the entrepreneur’s credit constraints. In a theoretical model and numerical simulation, White 2005; see also Akyol and Athreya (2005) argues that
the fresh start is economically efficient except when debtors behave strongly opportunistically... If opportunistic behavior is non-existent or weak, then the optimal policy is the fresh start combined with the highest wealth exemption... However if some or all debtors are strongly opportunistic, then the fresh start policy sometimes becomes inefficient.

Empirical studies by White and colleagues find support for both facets of the dilemma. Fan and White (2003) find that families are more likely to own and start businesses if they live in states with higher bankruptcy exemption levels (see also Armour and Cumming 2005). In tandem, Berkowitz and White (2004) show that lenders are more likely to turn down small firms in states that have higher exemptions. The question which effect dominates thus becomes an empirical one—that is: are potential entrepreneurs highly opportunistic or not? From a policy perspective, the dilemma becomes more complicated because the same set of exemptions is currently available both to consumers and to entrepreneurs. The issues become complex further yet when the entrepreneur can choose to conduct business in a neighboring jurisdiction with more favorable exemptions. Mathur (2005) indeed finds that higher bankruptcy exemptions in neighboring states lower the probability of starting a business in the state of residence. This, in turn, may engender a race among states to attract entrepreneurs to conduct business in and perhaps even migrate to their jurisdiction.

Lest the reader thought that the problem becomes intractable, two recent studies by Hall and colleagues cast a shadow over the entire discussion. These researchers investigated how the bankruptcy homestead exemptions influence rates of entrepreneurship over time in eight US states, with entrepreneurship being represented as the share of business proprietors (regardless if that business is incorporated) in the working-age population. These researchers find an S-shaped relationship between the homestead exemption and entrepreneurship. Specifically, an increase in the homestead exemption from very low or very high levels acts to reduce the number of entrepreneurs, while an increase in the middle range acts to increase the number of entrepreneurs.

The results are striking. Garrett and Wall (2006) unequivocally indicate that the best policy for promoting entrepreneurship is zero exemption. Georgellis and Wall (2006) at first blush suggests that there may be some room for promoting entrepreneurship through a homestead exemption in approximately the 50–70% range. In a personal exchange with the present author, however, Wall advised that the differences between the two studies may stem from a small difference in year coverage of the data and, more importantly, that the positive section of the curve from Georgellis and Wall (2006) may not be significantly different from zero.
Stated otherwise, these econometric analyses, which appear the most sophisticated thus far, suggest that the best entrepreneurship-promoting policy would advocate abolishing the homestead altogether. Perhaps entrepreneurs are too highly opportunistic, as White has cautioned; perhaps lenders cannot distinguish entrepreneurship-debtors from consumption-debtors; perhaps the reason remains to be discovered.

6 Conclusion

Inspired by Schumpeter’s seminal depiction of the entrepreneur, this chapter sought to recast this heroic portrait in a more rigorous theoretical framework. To this end, I leverage a model of value preferences developed by Schwartz. The entrepreneurial spirit, it is argued, consists of particular value preferences: high self-enhancement and high openness-to-change. These hypotheses are consistent with extant empirical evidence. The upshot of this theory – especially when the stability of cultural value orientations is taken into account – is that individual propensities to engage in new venture creation may not be very amenable to policy measures. Looking specifically at legal rules, this chapter attempted to identify measures that could be narrowly targeted at promoting entrepreneurship by making entrepreneurs even more highly motivated than what they appear to be. Recent research indicates, however, that theoretical and empirical issues, which must be resolved before such measures could be employed with confidence, are intractable at this point.

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