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EMPOWERING INNOVATION: THE NEXUS OF ECONOMIC FREEDOM AND ENTREPRENEURSHIP

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EMPOWERING INNOVATION: THE NEXUS OF ECONOMIC FREEDOM AND ENTREPRENEURSHIP

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Summary

This entry into the Menard Family Initiative Decoded Series explores the relationship between economic freedom and entrepreneurship, emphasizing the importance of policies that enhance economic freedom to stimulate entrepreneurial activity. Economic freedom, characterized by minimal government intervention, strong property rights, and competitive markets, is crucial for fostering entrepreneurship. The analysis points to the complementary factors - access to finance, supportive infrastructure, and a culture that encourages risk-taking and innovation – that are crucial along with economic freedom to chart a successful entrepreneurial path.

Through statistical analysis, theories, and case studies, the paper demonstrates how policies related to economic freedom can boost entrepreneurial activities, minimize challenges, and improve access to finance. It also addresses the unique challenges faced by women and examines targeted policies and initiatives that various countries have implemented to support female entrepreneurs. Key takeaways include the necessity of reducing regulatory burdens, securing property rights, and providing tailored financial products. Furthermore, fostering a supportive ecosystem with mentorship, training, and networking opportunities is essential.

Chapter 1: Introduction

Entrepreneurship has been regarded as an important driving force for economic growth and development. In the 20th century, industrialized economies like the United States, Germany, and Sweden greatly benefited in terms of economic development from entrepreneurship, driven by the decline in manufacturing and the shift toward service businesses. Among the forces accelerating entrepreneurship, economic freedom has been regarded as a vital component to increase the opportunity and growth of entrepreneurship. Economic freedom is the ability of individuals and businesses to make economic decisions without government or external interference, encompassing property rights, free trade, low taxation, and minimal regulation.

Entrepreneurship, on the other hand, involves the process of identifying opportunities, taking risks, and creating value through innovation and business ventures. Thus, an entrepreneur is an individual who identifies opportunities, takes calculative risks, and innovates to create and manage a business venture. People choose to be entrepreneurial given many other options in society because economic freedom efficiently allocates the talent of entrepreneurship within a society by securing and enforcing property rights, endorsing lesser regulations, and favorable tax policies. Economic and political freedom create the reward and incentive structure through which entrepreneurial efforts grow and are nurtured in an economy.

This essay explores the relationship between economic freedom and entrepreneurship, drawing on empirical evidence and theoretical insights to shed light on the factors shaping entrepreneurial activity and the policy implications for fostering a dynamic entrepreneurial ecosystem. Research indicates that higher levels of economic freedom correlate with increased rates of new business creation and entrepreneurial aspirations, highlighting its pivotal role in fostering innovation and investment (Nyström, 2008). However, the extent and nature of entrepreneurial activity within economically free societies are influenced by factors such as access to capital, supportive infrastructure, and cultural attitudes towards risk-taking.

Conversely, entrepreneurs in less economically free settings face challenges such as regulatory burdens and limited access to capital, yet they also find opportunities in addressing unmet market needs and driving social change.

By incorporating basic statistics, theories, and case studies, this essay provides a comprehensive overview of how policies related to economic freedom can boost entrepreneurial activities, minimize challenges, and ease access to finance for entrepreneurs. The study also highlights the unique challenges faced by different groups, especially women, and discusses the policies and initiatives taken by various countries to support and promote female entrepreneurship.

Chapter 2: Defining Economic Freedom

Economic freedom refers to the ability of individuals and businesses to make economic decisions with minimal interference from government or other external entities. It encompasses several key elements, including the protection and enforcement of property rights, low taxation, limited government regulation and favoring free market competition, open trade and investment policies, and sound monetary systems. Economic freedom allows for the efficient allocation of resources, encourages entrepreneurship and innovation, fosters economic growth, and enhances overall prosperity within a society.

The Economic Freedom of the World (EFW) index, provided by the Fraser Institute, assesses the level of economic freedom of countries within five critical domains: Size of Government, Legal System and Security of Property Rights, Sound Money, Freedom to Trade Internationally, and Regulation. A higher EFW index score indicates a better quality of institutions, signaling a more conducive environment for entrepreneurship and economic growth.

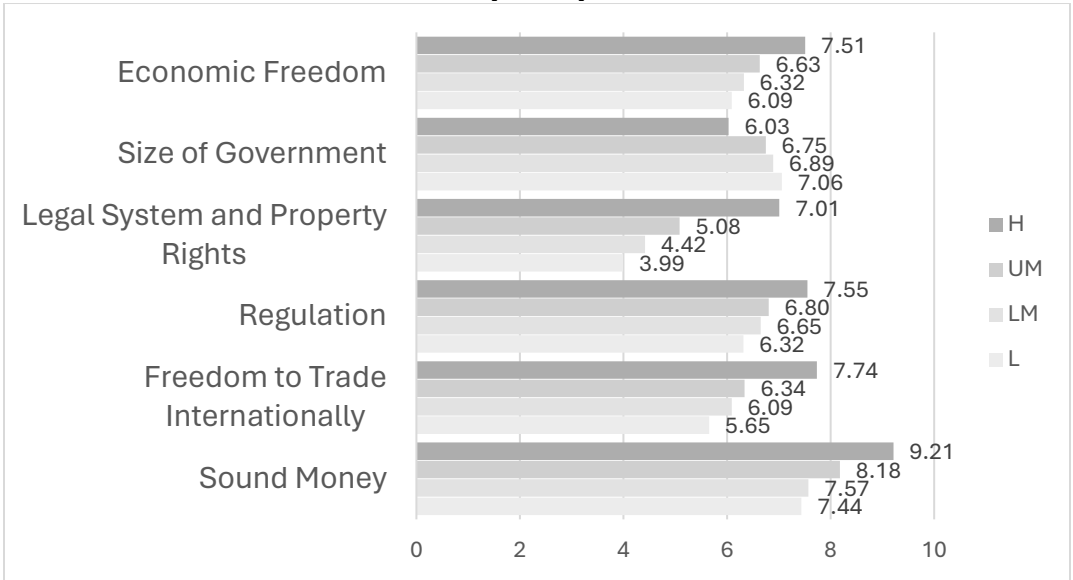
Table 1: Countries with Highest and Lowest Economic Freedom Score in 2020

Countries (High EFW)	EFW Score	Countries (Low EFW)	EFW Score
Hong Kong	8.59	Venezuela, RB	3.32
Singapore	8.48	Sudan	4.21
Switzerland	8.37	Zimbabwe	4.48
New Zealand	8.27	Syrian Arab Republic	4.63
Denmark	8.09	Argentina	4.87

Data source: Economic Freedom of the World (EFW) index, Fraser Institute

Using the data from Fraser Institute, Table 1 highlights the contrast in economic freedom between countries with the highest and lowest Economic Freedom of the World (EFW) scores in 2020. Nations such as Hong Kong, Singapore, and Switzerland lead with high EFW scores, indicating environments with minimal government interference, strong property rights, and competitive markets. Conversely, countries like Venezuela, Sudan, and Zimbabwe, with significantly lower EFW scores, face substantial regulatory and economic barriers.

Figure 1: Economic Freedom of Countries with Different Income Levels (2020)



Data source: Economic Freedom of the World (EFW) index, Fraser Institute

Figure 1 visually represents the Economic Freedom scores across countries with varying income levels for the year 2020. It highlights significant disparities in economic freedom associated with income levels, demonstrating that higher economic freedom correlates with higher income.

High-income countries (H) consistently score the highest across all dimensions, particularly in Sound Money and Regulation, suggesting a stable monetary environment and efficient regulatory frameworks that support economic activities. Upper-middle-income countries (UM) follow, showing relatively strong performance but with notable room for improvement in areas like Legal System and Property Rights. Lower-middle-income countries (LM) and low-income countries (L) display progressively lower scores, indicating greater regulations, weaker legal protections, and less freedom in trade and monetary policies.

Chapter 3: Defining Entrepreneurship

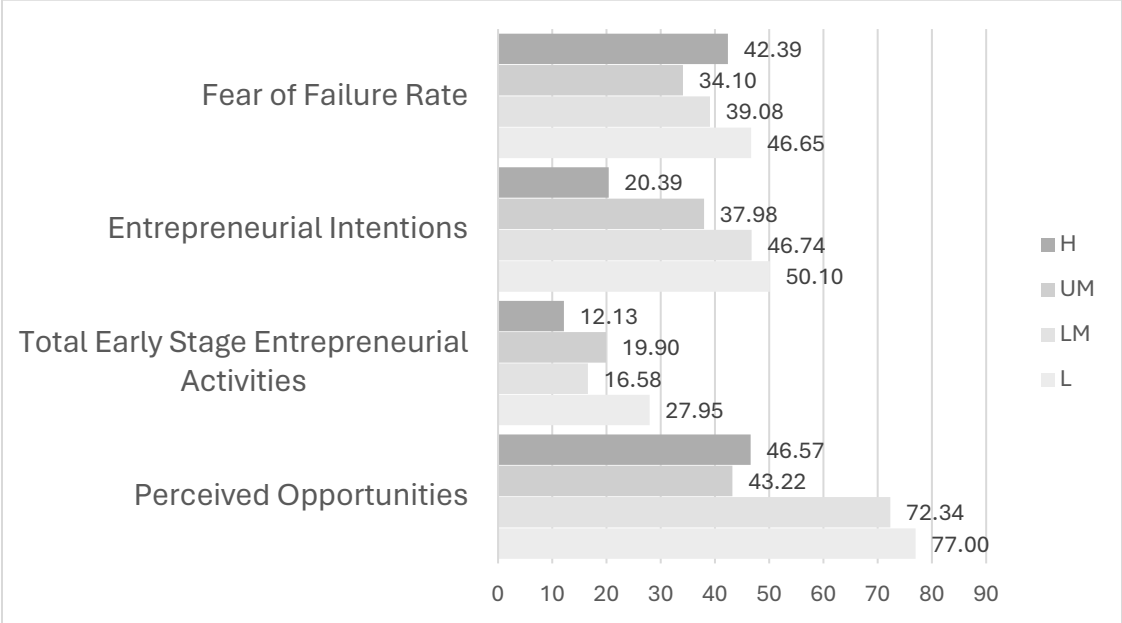
Entrepreneurship is often recognized as a fundamental driver of economic growth and development. At its core, entrepreneurship involves the process of identifying opportunities, taking calculated risks, and creating value through innovation and business ventures. Entrepreneurs are individuals who, motivated by the pursuit of opportunities, rationalize resources and capabilities to create new products, services, or processes that address unmet needs or improve existing offerings (Shane & Venkataraman, 2000).

One of the key aspects of entrepreneurship is opportunity recognition. Entrepreneurs are adept at spotting gaps in the market or inefficiencies within existing systems and leveraging these insights to develop innovative solutions. This ability to perceive and seize opportunities is a critical factor that distinguishes entrepreneurs from non-entrepreneurs (Kirzner, 1973). Another defining characteristic of entrepreneurship is risk-taking. Entrepreneurs often operate in uncertain environments, where the outcomes of their ventures are not guaranteed. The willingness to take on financial, personal, and social risks is a hallmark of entrepreneurial activity. However, successful entrepreneurs are not reckless; they engage in calculated risk-taking, assessing potential rewards against possible downsides (Knight, 1921).

Innovation is also central to the entrepreneurial process. Entrepreneurs drive economic progress by introducing new ideas, products, or services. This innovation can be incremental, involving small improvements, or radical, leading to groundbreaking changes in industries or markets (Schumpeter, 1934). Through innovation, entrepreneurs contribute to the dynamic nature of the economy, fostering competition and spurring further advancements. Entrepreneurial activities can be broadly categorized into two types: necessity-driven and opportunity-driven entrepreneurship. Necessity-driven entrepreneurs are those who start businesses due to a lack of better employment options. In contrast, opportunity-driven entrepreneurs are motivated by the perception of a viable business opportunity and the desire to capitalize on it (Reynolds et al., 2002). More specifically, whereas a necessity entrepreneur can be one after running out of alternate choices, an opportunity chooses to pursue entrepreneurship amid alternate choices. Both types play vital roles in the economy, though opportunity-driven entrepreneurship is often associated with higher levels of innovation and economic impact.

Based on data from the Global Entrepreneurship Monitor (GEM) for the year 2020, Figure 2 presents various measures of entrepreneurial activity across countries with different income levels. The measures include Fear of Failure Rate, Entrepreneurial Intentions, Total Early-Stage Entrepreneurial Activities (TEA), and Perceived Opportunities. Fear of Failure Rate reflects the percentage of the working-age population who perceive opportunities but are deterred from starting a business due to fear of failure. Entrepreneurial Intentions indicate the percentage of the adult population who intend to start a business within the next three years. Total Early-Stage Entrepreneurial Activities (TEA) measure the percentage of the adult population actively involved in starting or managing a new business. Lastly, Perceived Opportunities reflect the percentage of individuals who see good opportunities to start a business in the area where they live.

Figure 2: Entrepreneurial Activity of Countries with Different Income Levels (2020)



Data source: Global Entrepreneurship Monitor

Higher-income countries (H) exhibit a lower Fear of Failure Rate (42.39%) compared to low-income countries (L) (46.65%). This suggests that economic stability and support systems in higher-income countries may reduce the perceived risks of entrepreneurship. Additionally, high-income countries (H) show a lower Entrepreneurial Intention rate (20.39%) compared to low-income countries (L) (50.10%). This disparity might reflect the greater economic

opportunities and alternative career options available in high-income countries, reducing the necessity to pursue entrepreneurship out of necessity.

High-income countries (H) also report lower Total Early-Stage Entrepreneurial Activities (TEA) (12.13%) than low-income countries (L) (27.95%). This may be due to the higher barriers to entry and regulatory burdens in lower-income countries, which encourage more informal and necessity-driven entrepreneurial activities. Interestingly, high-income countries (H) have a lower Perceived Opportunity rate (46.57%) compared to low-income countries (L) (77.00%). This could indicate that individuals in lower-income countries are more likely to see gaps in the market and opportunities for business, possibly due to unmet needs and less saturated markets.

Chapter 4: Role of Economic Freedom in Fostering Entrepreneurial Activity

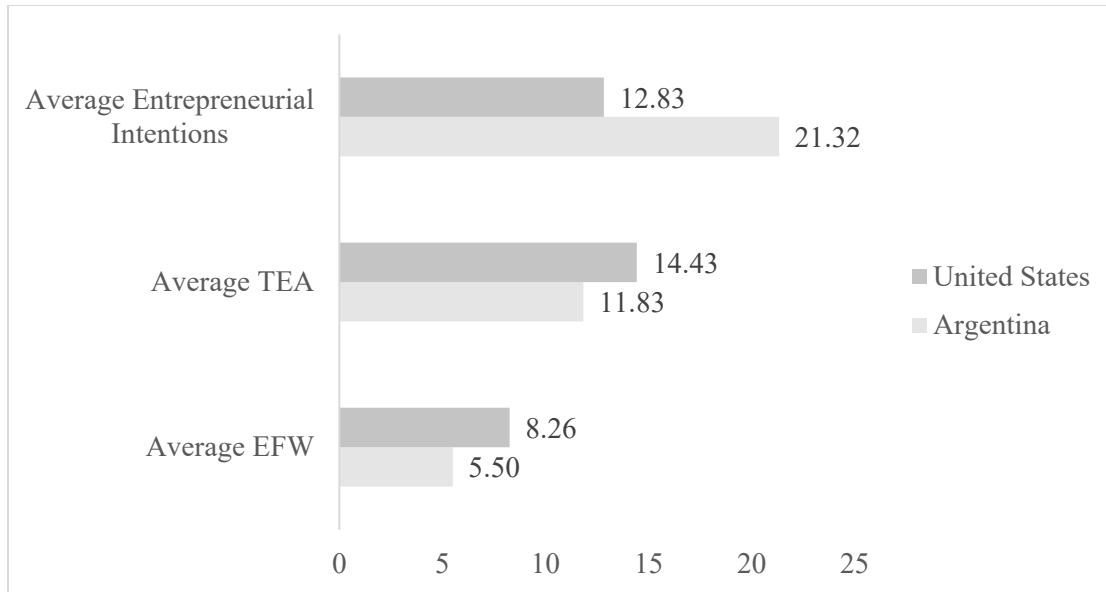
Economic freedom is recognized as a crucial factor that accelerates entrepreneurship, fostering increased opportunities and growth (Ovaska & Sobel, 2005; Kreft & Sobel, 2005). Nyström (2008) suggests that economic freedom enhances entrepreneurial intentions and the likelihood of individuals engaging in entrepreneurial activities. Extensive research consistently demonstrates the positive influence of economic freedom on entrepreneurship, with numerous studies revealing a strong correlation between economic freedom and higher rates of entrepreneurial activity (Bjørnskov & Foss, 2008; Herrera-Echeverri & Estévez-Bretón, 2014; Nyström, 2008). Countries with fewer regulations, lower taxes, and robust property rights tend to have vibrant entrepreneurial ecosystems, leading to increased business creation, innovation, and job opportunities.

Strong legal protections for property rights and contract enforcement reduce uncertainty and encourage investment (La Porta et al., 1997). A streamlined regulatory environment with reasonable tax rates reduces bureaucratic hurdles, making it easier for entrepreneurs to start and operate businesses (Klapper et al., 2011). Conversely, regulatory complexities can discourage potential entrepreneurs due to the extensive paperwork and administrative procedures involved (Bowen & De Clercq, 2008). Baumol (1996) argues that excessive regulation can decrease entrepreneurship's contribution to economic growth, as many firms might find it more beneficial to influence the regulatory environment.

Access to credit and investment capital is crucial for entrepreneurs to fund innovative ideas and scale their businesses (Beck & Demirguc-Kunt, 2006). Strong economic freedom fosters a developed financial infrastructure, robust banking systems, credit reporting mechanisms, and collateral registries, which reduce information asymmetry and facilitate credit provision to entrepreneurs, promoting competition and innovation in the financial sector. Government interventions have traditionally been analyzed within the context of economic freedom, with excessive interventions potentially reducing entrepreneurial opportunities by creating market concentration, limiting competition, and establishing barriers to entry (Friedman, 1962; Demsetz, 1982).

When comparing countries with varying levels of economic freedom, a notable disparity emerges in total entrepreneurial activities. The correlation between economic freedom and Total Early-Stage Entrepreneurial Activity (TEA) in the United States and Argentina from 2015 to 2020 is positive (0.24), while the correlation between economic freedom and entrepreneurial intentions is negative (-0.75). Countries with higher economic freedom, such as the United States, typically exhibit a greater number of early-stage entrepreneurial ventures compared to those with lower economic freedom, such as Argentina. This difference is evident not only in economic freedom scores, which are higher for the United States, but also in the actual prevalence of early-stage entrepreneurship. Interestingly, while Argentina shows higher average entrepreneurial intentions, the gap between intentions and the actual establishment of new firms is narrower in the United States. This suggests that in economically free societies like the United States, individuals with entrepreneurial intentions are more likely to translate those intentions into concrete business ventures. In contrast, in less economically free societies like Argentina, the less conducive business environment may deter some aspiring entrepreneurs from realizing their intentions, leading to a lower number of new firms compared to the initial intentions.

Figure 3: Entrepreneurship in Countries with High and Low Economic Freedom

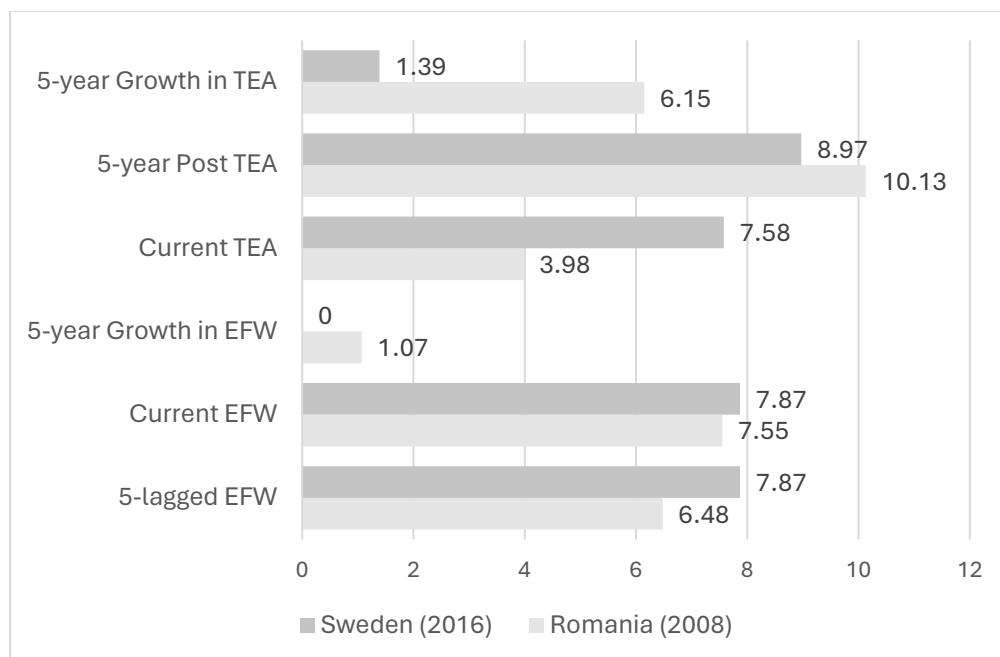


Note: Average over 2015-2020

Comparative analysis further underscores the significant impact of economic freedom on entrepreneurship. To better understand the impact of economic freedom on entrepreneurship, Figure 4 compares two countries: one that experienced an increase in economic freedom and another with stable economic freedom levels, both having similar current economic freedom. We then compare the increase in total entrepreneurial activities five years after the change in economic freedom.

Romania experienced a significant increase in its Economic Freedom score by 1.07 points (equivalent to one standard deviation of the overall score for all countries), rising from 6.48 in 2003 to 7.55 in 2008. In contrast, Sweden maintained a similar Economic Freedom score of 7.87 from 2011 to 2016, with no change. Five years after the increase in economic freedom, Romania experienced a growth in total early-stage entrepreneurial activities by 6.15 points in 2013, whereas Sweden experienced an increase of only 1.39 points in 2021. This demonstrates that enhancements in economic freedom can significantly boost entrepreneurial activities. Therefore, policymakers aiming to stimulate entrepreneurship should focus on enhancing economic freedom by reducing regulatory burdens, securing property rights, and improving access to financial resources.

Figure 4: Impact of Increase in Economic Freedom Increase on Growth in Entrepreneurial Activity



There are several policies and regulations directly related to economic freedom that support entrepreneurs in different countries. For example, in 2012, the USA passed the Jumpstart Our Business Startups (JOBS) Act, which eases regulations on small businesses seeking to go public or raise capital through crowdfunding. In India, the Startup India Initiative offers tax benefits, simplified regulatory requirements, and easier access to funding for startups. Similarly, the United Kingdom's Enterprise Investment Scheme (EIS) provides tax relief to investors who buy shares in high-risk small businesses, encouraging investment in startups.

Economic freedom also boosts foreign investment through various policies. For instance, Singapore's EntrePass work visa scheme allows foreign entrepreneurs to start and operate businesses in Singapore. In Canada, the Start-Up Visa Program attracts foreign entrepreneurs by offering permanent residency to those who establish innovative businesses.

To encourage innovation and support small firms, initiatives like Mudra Yojana in India, the R&D Tax Incentive, and the New Enterprise Incentive Scheme (NEIS) in Australia have been successful. Mudra Yojana provides micro-financing to small and medium enterprises, particularly in rural areas. The R&D Tax Incentive offers tax offsets for companies conducting research and development, promoting innovation and technological advancement. The

NEIS provides training and mentoring to help unemployed individuals start their own businesses.

Chapter 5: Economic Freedom and Gender Gap in Entrepreneurship

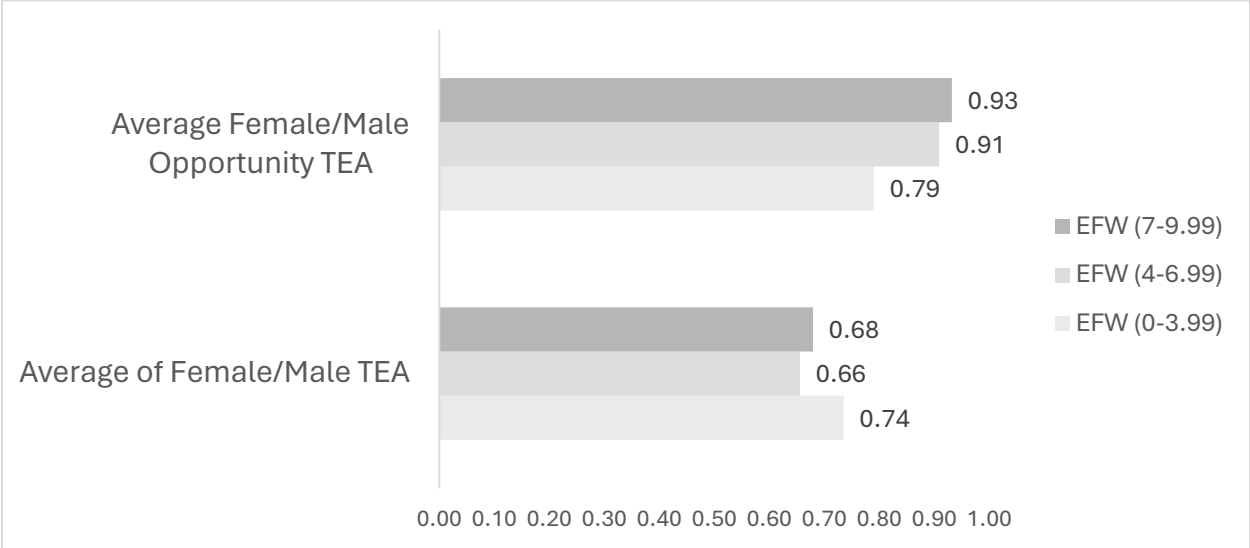
While economic freedom increases overall entrepreneurship, its impact on men and women can vary significantly due to various socio-economic and cultural factors. Women often face unique barriers to entrepreneurship, such as limited access to financial resources, restrictive social norms, and lower levels of educational and professional experience compared to men. In societies with higher economic freedom, where property rights are robust and regulatory burdens are minimal, these barriers may be reduced, enabling women to participate more actively in entrepreneurial activities (Brush, 2006; Aidis et al., 2008). However, even in such environments, gender-specific challenges persist, such as discrimination in lending practices or fewer networking opportunities.

Moreover, due to gender-defined social dynamics, men may be more effective in dealing with government officials and addressing corruption-related issues (Bardasi et al., 2011). This effect is more prominent in countries with weaker rule of law, impacting "high aspiration" entrepreneurial projects more significantly. Consequently, women are less inclined than men to engage in entrepreneurial activities in such countries. A larger state sector can deter entrepreneurial entry (Verheul et al., 2006), and this impact is more negative for female entrepreneurs. The decision for women to engage in entrepreneurship is more sensitive to contextual factors because of the higher perceived opportunity cost. A larger state sector can demotivate women by offering security, educational services, healthcare, and housing while reducing relative rewards. Conversely, a smaller state sector implies limited social security provisions, potentially incentivizing women to become more economically active and engage in entrepreneurship. Thus, female economic decisions are more influenced by the size of government compared to men, making them less likely to engage in entrepreneurial activities in countries with a larger state sector.

To understand the relationship between economic freedom and the gender gap in entrepreneurship, Figure 5 presents entrepreneurship measures in

countries with high, medium, and low levels of economic freedom. Countries with higher economic freedom not only exhibit higher levels of overall entrepreneurship but also demonstrate a reduced gender gap in entrepreneurial participation. In nations with a higher economic freedom index, the ratio of female to male total early-stage entrepreneurial activities is more favorable towards females, although the ratio is high in countries with low economic freedom. However, opportunity-driven entrepreneurial activities are higher in countries with higher economic freedom. This indicates that higher economic freedom can create an environment where women are more likely to engage in entrepreneurial ventures, not solely out of necessity but also because they perceive opportunities within the economically free society.

Figure 5: Gender Gap in Entrepreneurship and Economic Freedom



Note: Average over 2010-2020

Countries have adopted numerous policies and initiatives directly related to high economic freedom, promoting entrepreneurship by improving access to capital, reducing regulatory barriers, and providing the necessary support for female entrepreneurs to thrive. For example, the National Women’s Business Council (NWBC) in the United States is an independent advisory council that advocates for policies to support female entrepreneurs, focusing on improving access to capital, markets, and networks. In Canada, the Women Entrepreneurship Strategy (WES) is a comprehensive plan aimed at increasing women’s access to financing, talent, networks, and expertise, with a focus on

building a venture capital environment for female entrepreneurs. Australia's ExportConnect Program assists female entrepreneurs in expanding their businesses internationally by providing grants, resources, and reducing regulatory barriers to trade. The KfW Women Entrepreneurs Finance Initiative in Germany offers tailored financial products and services to support women entrepreneurs, emphasizing improved access to capital and reduced regulatory hurdles.

Additionally, countries have launched various initiatives to address the unique challenges faced by female entrepreneurs, providing targeted support to help them succeed and thrive in their business ventures. These initiatives include training, counseling, mentorship, and funding programs such as Women's Business Centers (WBCs) in the United States, the Enterprise Diversity Alliance (EDA) in the United Kingdom, Futurpreneur Canada, Stand Up India, and the Mahila Udyam Nidhi Scheme in India. Other examples are FRAUEN unternehmen in Germany and the Qredits Women Entrepreneur Program in Sweden. These efforts collectively enhance economic freedom and foster a supportive ecosystem for female entrepreneurship.

Chapter 6: Complementary Factors Enhancing Economic Freedom

While economic freedom plays a crucial role in fostering entrepreneurial activity, its effectiveness is significantly enhanced by several complementary factors. These factors, including access to finance, supportive infrastructure, and a culture that encourages risk-taking and innovation, are essential in creating a robust entrepreneurial ecosystem (Stam & Spigel, 2016; Mason & Brown, 2014).

Access to financial resources is fundamental for entrepreneurs to start and scale their businesses (Kerr & Nanda, 2011). Economic freedom promotes a developed financial infrastructure, robust banking systems, credit reporting mechanisms, and collateral registries (Defung & Yударuddin, 2022). These elements reduce information asymmetry and facilitate credit provision, thereby promoting competition and innovation in the financial sector (Su & Si, 2015). However, without adequate access to finance, the benefits of economic freedom can be limited.

Supportive infrastructure, such as reliable transportation, communication networks, and utilities, is vital for business operations. A well-developed infrastructure reduces operational costs and increases efficiency, enabling entrepreneurs to focus on innovation and growth. The impact of economic freedom could be amplified by private investment in infrastructure projects that support business activities (Bennett, 2019).

A culture that encourages risk-taking and innovation is also essential for entrepreneurship. While economic freedom provides the framework for entrepreneurial activities, cultural attitudes significantly influence the willingness of individuals to take risks and pursue new ventures (Kreiser et al., 2010). Societies that celebrate entrepreneurial success and tolerate failure are more likely to see higher levels of entrepreneurial activity (Cardon et al., 2011). Educational programs, media representation, and public policies can help foster a culture of innovation.

Several countries have successfully integrated these complementary factors with economic freedom to boost entrepreneurship. For instance, the United States' JOBS Act eases regulations on small businesses seeking to go public or raise capital through crowdfunding. India's Startup India Initiative offers tax benefits, simplified regulatory requirements, and easier access to funding for startups. These examples highlight the importance of combining economic freedom with supportive measures to create a conducive environment for entrepreneurship.

Chapter 7: Conclusion

In conclusion, economic freedom and entrepreneurship are closely intertwined, with economic freedom providing the necessary conditions for entrepreneurial activity to flourish. However, the relationship between economic freedom and entrepreneurship is complex, influenced by a range of factors including institutional quality, market conditions, and cultural norms. By understanding these dynamics and implementing policies that promote economic freedom and support entrepreneurship, societies can unlock the full

potential of their entrepreneurial talent, drive innovation, and achieve sustainable economic growth.

This study explores the intricate relationship between economic freedom and entrepreneurship, with a specific focus on how various policies and initiatives can foster a conducive environment for entrepreneurial activities. Countries that have adopted policies to improve economic freedom generally exhibit higher rates of business creation, innovation, and entrepreneurial opportunities. Through the examination of different countries' policies, it is evident that targeted support for female entrepreneurs can address unique challenges and promote gender equality in entrepreneurship.

Overall, the findings underscore the importance of economic freedom in promoting entrepreneurship and highlight the need for continuous policy innovation to support entrepreneurs, especially women, in realizing their full potential. By fostering an environment of economic freedom, countries can unlock the entrepreneurial talent of their populations, driving sustained economic growth and societal prosperity.

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