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# The Relationship between Entrepreneurship Development and Unemployment Reduction in Pakistan

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**Abstract-** Entrepreneurship is considered as a medium of tackling the problems of unemployment. The purpose of this study is to examine the need in order to reduce unemployment through entrepreneurship in Pakistan. The regression results indicate that 91 percent variations in entrepreneurship development have been explained by the explanatory variables. The unemployment rate has been found to be negatively related to entrepreneurial development. High rate of unemployment has been associated with low level of entrepreneurial development in economy of Pakistan.

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# The Relationship between Entrepreneurship Development and Unemployment Reduction in Pakistan

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**Abstract-** Entrepreneurship is considered as a medium of tackling the problems of unemployment. The purpose of this study is to examine the need in order to reduce unemployment through entrepreneurship in Pakistan. The regression results indicate that 91 percent variations in entrepreneurship development have been explained by the explanatory variables. The unemployment rate has been found to be negatively related to entrepreneurial development. High rate of unemployment has been associated with low level of entrepreneurial development in economy of Pakistan.

## I. INTRODUCTION

Entrepreneurship is considered a major source of job creation, innovation and growth of an economy (Audretsch & Thurik, 2000). Entrepreneurship, defined as an “economic system” which has three main components: (1) entrepreneurs, who desires to achieve economic goals for survival (2) the social constitution, and (3) the Government (Lowrey, 2003). According to Wennekers and Thurik (1990) entrepreneurship is the willingness and ability of an individual person, who performs individually or may in teams, within the realm of an existing organization or outside the organization in order to create new economic opportunities, and he introduces his new concepts in the market, also faces uncertainty, makes decisions at the spot, uses and formulates institutions and resources. Entrepreneurship cannot be defined as a profession, entrepreneurship is a behavioral characteristic of individual (Wennekers & Thurik, 1999).

Each economy system has two categories which are active and inactive population. The economically active are those who are able and willing to work, and they engage themselves in the production of physical goods or provide services they are also called employed population while on the other hand inactive population or unemployed are those who are able and willing to work but they are unable to find an appropriate paid employment (Fajana, 2000). Entrepreneurship is considered as a medium of tackling the problems of unemployment because for the unemployed people it acts like an escape from poverty and with the help of it many people are pushed towards business possession (Baptista & Thurik, 2007).

Many scholars have given attention to entrepreneurship and its vigor to prompt employment, thus giving the attention to the significance and the relevance of this sub sector in the development of any given economy. The importance of entrepreneurship cannot be denied due to its influencing role in the development of economies especially among the Developing countries. In order to accentuate the significant role played by entrepreneurship parallel to the growth and the development of a given economy, it is mostly recommended as a “source of employment generation”. It mostly happens due to the potential of entrepreneurial activities which are accompanied with the positive effects on the economy of nation and the quality of life of people (Adejumo, 2001).

The relationship between entrepreneurship and unemployment is based on ambiguity. In one strand of literature it has been found that “unemployment encourages entrepreneurial activities, which is called “refugee effect”. While on the other hand, a very different concept is identified from the other literature strand that is, high rate of entrepreneurship reduces unemployment rate, which is called “Schumpeter effect” (Audretsch & Thurik, 2001). Carree and Thurik, (1998) have examined in their studies that how much do small firms affect industry output and growth. According to them entrepreneurship has positive relationship with economic growth. The study of both Carree and Thurik, (1998) point out those industries have a high rate of small business comparative to same industries in other countries have more output (Carree & Thurik, 1998).

### a) Purpose of the Study

The purpose of this study is to examine the need in order to reduce unemployment through entrepreneurship in Pakistan.

## II. LITERATURE REVIEW

Entrepreneur is a person who takes risk, identifies problems or loop holes in the market and then tries to convert these problems or loop holes into opportunities. When a person starts his own business it is called entrepreneurship. It is a process in which an individual identifies market opportunities in his own geographical area or country, estimates about his own

financial resources and then tries to create a value for customers who live in that geographical area or country.

Entrepreneurship means not only to provide goods and services for end users but also provides the raw materials for different types or organizations, firms or factories like sugar-canon for sugar mills, cotton for cotton factories etc... (Efe, 2014). The word entrepreneur is developed from the French word "entreprendre" meaning "to undertake". With the passage of time, the definition of entrepreneurship has been evolved as the world's economic structure changes (Hassan, 2013). Entrepreneurship is combination of capacity and attitude that helps the entrepreneur to create or establish the new business with the risk of success or failure (Nkechi, Ej, & Okechukwu, 2012). In recent years, the relationship between unemployment and entrepreneurship is seeking maximum attention from policy makers in European countries. In this scenario there are two main reasons why do entrepreneurship and small firms play an important role; first by the use of new technology entrepreneurial reduces the importance of mass production (Economies of scales) in different sectors. Secondly due to advancement in innovation and technology, it becomes an opportunity for new and small firms as well as entrepreneurship also becomes more flexible than the large corporations (Baptista & Thurik, 2007).

Entrepreneurship defined as an "economic system" that based upon three components, (1) entrepreneur is a person who wants to achieve his economic survival and progress; (2) social formation, the right of having freedom of business which is granted to employee; and (3) the government should create institutions that must protect the entrepreneurs and also motivate the entrepreneurs to achieve their objectives or economic goals (Lowrey, 2003).

#### a) *Entrepreneurship Development*

Entrepreneurship education is a great source of economic growth in developing countries. Unfortunately our education system has provoked the development of entrepreneurial qualities because it explicates young people to obey and reshape the facts and to indulge themselves in remuneration after completing their education. While an entrepreneur tends to hinge only his own creativity and judgments, learns through the process of trial and error and promotes his own job environment. While our educational system focuses only on the analytical thinking rather than on innovative ideas (Kourilsky, 1974).

Due to this reason scholars and policy makers are pondering over the basic need of educational system for entrepreneurship. This educational system conceives awareness of alternative career choices and enlarges the vision of individuals by adorning them with cognitive tools and preparing them to perceive and develop entrepreneurial opportunities. Because an

educational system plays the key role in order to develop qualities which are considered important for entrepreneurship (Reynolds, Bygrave, Autio, Cox, & Hay, 1990).

An economy growth can be made possible with the help of greater number of entrepreneurs and more effective innovation (Holcombe, 2006). The major role played by an entrepreneur is taking risk, identifying and also changing the market conditions according to customers or consumer's needs, wants or demands (Knight, 1921). Cantillon, (1993) identifies the major role of entrepreneur is to mediate i.e. correspond supply and demand and also to use the scarce resources carefully and efficiently (Cantillon, 1931).

Another researcher Joseph Schumpeter has defined entrepreneur is a person who introduces or invents new products or combination of products. Entrepreneurship is created when an entrepreneur invents disruptive innovation new product or services in the market or economy (Schumpeter, 1934). According to Schultz Entrepreneur has unique ability to deal disequilibrium of the economy (Schultz, 1975).

#### b) *Main players in Entrepreneurship Development*

Now today's entrepreneurship has been encouraged by different universities, institutions and R & D. During the last decades entrepreneurship also has been encouraged by NGOs and these NGOs are playing an important role of promoting the entrepreneur concept. Media also provides the great awareness and it has been participating to promote the entrepreneur concept (Hang & Van, 2007).

#### c) *Unemployment*

The International Labor organization (ILO) defines unemployment as the people in the economy who are capable, willing and seeking for work but they can't find proper job in the economy and also those people who have left the job intentionally and unintentionally (Hassan, 2013). All economy has been characterized by active and passive population. Active population means those people or persons who are having technical skills or specialized knowledge and also those people who are able and willing to work and to produce products and services for customers or end users (Oladele, Akeke, & Oladunjoye, 2011).

Passive population or unemployment means a situation in which people are capable and willing to do some work for their economic benefits or to fulfill their needs but can't find a proper job. It's the macro-level problem and Government should monitor and sort out this problem. When unemployment rate in an economy system increases then poverty ultimately increases due to this reason (Fajana, 2000).

#### d) *Unemployment Reduction*

Individual who are unemployed and working low wage rate or under employment will shift to self-

employment or entrepreneurship as best possible alternative to increase their income (Oxenfeldt, 1943). When unemployment increases then the opportunity cost decreases. Due to this reason business startup activities will be increased (a. R. Thurik, Carree, van Stel, & Audretsch, 2008)

Entrepreneurship is facilitating by both local resources and raw material. With the help of entrepreneurship by establishing new enterprises in the economy, they will create suitable opportunities for unemployed people at low capital cost. Entrepreneurship is a flexible business which adapts easily unexpected changes in the economy. In local entrepreneurship, the local individual can start his business easily and he can also manage his own business with minimal resources in developing countries (Hassan, 2013).

All economy has been characterized by active and passive population. Active population means those people or persons who are having technical skills or specialized knowledge and also those people who are able and willing to work and produce product and services for customers or end users (Oladele, Akeke, & Oladunjoye, 2011).

Now these days unemployment is most common issue in Pakistan and it is faced by many individuals in Pakistan. Unemployment means the individuals who are having all the abilities and they are willing to perform tasks or work, but unable to find job. In 2011 the number of unemployed individuals in Pakistan is more than 3 million (Muhammad & Iqbal, 1998).

#### e) *Entrepreneurship and Unemployment*

There are two different Psychological theories regarding the relationship between unemployment and entrepreneurship these are called Schumpeter and Refugee effects. Schumpeter effect describes negative relationship between unemployment and entrepreneurship, while Refugee effect explains the positive relationship between unemployment and entrepreneurship (Oladele, Akeke, & Oladunjoye, 2011).

The relationship between entrepreneurship and unemployment is positive as well as it portrays a negative relationship. Positive relationship occurs when rate of unemployment increases the number of new enterprises or rate of entrepreneurship also increases in the economy and generates employment. This relationship is called The Refugee Effect (Oxenfeldt, 1943). When new firms are introduced or established in the society then its needed employees work for them, and this ultimately becomes the reason of reduction in unemployment (Pfeiffer & Reize, 2000). Negative relationship occurs when number of entrepreneurship is increased in the economy the unemployment rate is decreased. This effect is called Schumpeter effect (Garofoli, 1994).

According to Garofoli, (1994) new business startups and unemployment are negatively related, because new enterprises increase employment and reduce unemployment (Garofoli, 1994). Unemployment and entrepreneurship has been wrapped in an ambiguous relationship. It is generally recognized that there is a bi-directional the causal link between changes in the level of entrepreneurship and unemployment, while doing business a "Schumpeter effect" helpsto reduce unemployment, on the other hand "refugee effect" or "merchant or shopkeeper" has stimulating effect of unemployment entrepreneurship (R. Thurik, 2003). Entrepreneurial opportunities have not only become the part of push effect of unemployment but also they showed the pull effect (SALEH, G. FARJADI, & MOHAMMADPOUR, 2011).

### III. METHODOLOGY

Secondary data has been used for this study. The sources of data are the official documents of Pakistan which has been named as economic survey of Pakistan and Bureau of Statistics Pakistan. It has covered the duration of 10 years from 2003 to 2012. The data which has been collected is analyzed by using multiple regression models of three functional forms initially after which the one which having the highest R<sup>2</sup> and better F ratio, the linear form, has been selected as the primary model.

The analysis is based on the multiple regression model such as linear, double log, semilog, because it is suitable for explaining economic phenomena with many unlike explanatory variables (Onoja & Agumagu, 2009). The multiple regression analysis is a powerful statistical tool that expresses the relationship between two or more variables so that one variable can be predicted from the other. The implicit form of the multiple regression models is given by  $Y = f(X_1, X_2, X_3, X_4, X_5, X_6, X_7, X_8 + u)$ .

Where Y = Industrial Production Index (as proxy for entrepreneurship development) which is the dependent variable.

X<sub>1</sub> = Agricultural Production Index

X<sub>2</sub> = Capacity Utilization Index

X<sub>3</sub> = Inflation rate

X<sub>4</sub> = Unemployment rate

X<sub>5</sub> = Exchange rate of Rs./\$

The explicit form of the model is:

$$Y_t = b_0 + b_1 X_{t1} + b_2 X_{t2} + b_3 X_{t3} + b_4 X_{t4} + b_5 X_{t5} + b_6 X_{t6} + u$$

Y<sub>t</sub> and X<sub>t</sub> refer to the respective dependent and explanatory variables at the given time periods coded and given earlier.



a) *Hypothesis of the Study*

**H1:** There is significant relationship between entrepreneurship development and unemployment reduction in Pakistan.

## IV. RESULT AND DISCUSSION

The regression result of the analysis shows that ordinary linear model is the best fitted scale for the analysis. It fulfils some of the requirements such as R<sup>2</sup>, F statistics and expected signs. For the entrepreneurial development, the result is explicitly stated as; Industrial production index = 6.126 + 61.25 Agriculture – 3160 Inflation Rate- 31615.63 Unemployment Rate. 96704 Exchange Rate. R<sup>2</sup> = 0.91

The results indicate that 91 percent variations in entrepreneurship development have been explained by the explanatory variables. The results indicate that the entire explanatory variables particularly agricultural production index is the only significant variable influencing entrepreneurship development. The variable is significant at 5% level. The positive sign indicates that due to the increment in agricultural production index would increase entrepreneurial development.

This finding could have been done due to significant percentage of workers who are engaged in agricultural activities. The rate of inflation has been found having negative and non-significant influence on entrepreneurial development. Similarly unemployment rate has been found to be negatively related to entrepreneurial development.

This finding agrees with works like Solomon *et al.* (2002). High rate of unemployment has been associated with low level of entrepreneurial development in any economy. This justifies the need entrepreneurial activities should increase in order to reduce high rate of unemployment (Solomon, Duffy, & Tarabishy, 2002).

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