



## The Effect of Financial Development on the Status of Entrepreneurship in Selected Countries

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### Article Info

**Article Type:** Research Article

**Article History:**

Received: 15 March 2021

Received in revised form: 23 May 2021

Accepted: 05 July 2021

Published online: 01 July 2023

**Keywords:**

*Entrepreneurship, Financial Development, Finance Depth.*

**JEL Classification:**

*L26, O16, G18.*

### ABSTRACT

Financial resources, particularly at the early stages of entrepreneurship, play a crucial role, and the lack of these resources is recognized as a major obstacle for entrepreneurs. To address this issue, this study examines the impact of financial development on entrepreneurship in 44 developing and developed countries between 2008 and 2018. Private sector credit to GDP and market capitalization to GDP are considered as independent variables, while perceptions of corruption, inflation rate, and per capita GDP serve as control variables. The findings of the six estimated models demonstrate the stability of the coefficients and models. The results reveal a positive correlation between private sector credit to GDP and the entrepreneurship index. Additionally, the second index of financial development exhibits a positive and significant relationship with the index of entering entrepreneurship. The coefficients of the corruption perception index are also positive for both models, indicating that reducing corruption can facilitate the process of entering into business.

**Cite this article:** Ansari Samani, H., Mirzapour, M., & Asgari, R. (2023). The Effect of Financial Development on the Status of Entrepreneurship in Selected Countries. *Iranian Economic Review*, 27(2), 447-469. DOI: <https://doi.org/10.22059/ier.2021.85010>



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**Publisher:** University of Tehran Press.

DOI: <https://doi.org/10.22059/ier.2021.85010>

## **1. Introduction**

Since 1999, the Global Entrepreneurship Monitor (GEM) has been the most significant reference for evaluating entrepreneurial activities in different countries. GEM defines entrepreneurs as individuals who own a business that seeks to create value by identifying, evaluating, and exploiting new products, services, and markets. In recent years, rapid changes in science and technology have presented new challenges to countries, particularly less developed ones, which require creative approaches and methods. Thus, reinforcing entrepreneurship should be a priority for countries (Teixeira and Casteleiro, 2018). Entrepreneurs are crucial as they drive society towards technical and innovative changes, accelerate economic growth, and transform new knowledge into new services and products (Liu and Wu, 2019).

Several factors can determine entrepreneurship, including financial factors, organizational factors, framework, and economic conditions. Financial factors, especially in the early stages of entrepreneurship, play a significant role, and the lack of financial resources is considered one of the primary obstacles for entrepreneurs (Liu and Wu, 2019). Financing entrepreneurs can be deemed the responsibility of the financial system (Dehejia and Gupta, 2019), which equips surplus resources in the economy and allocates them to applicants. Through financial development, individuals in the community can access affordable tools, services, markets, and financial intermediaries. In a developed financial market, principles such as freedom of choice and transparency of information are observed, and suppliers and applicants of financial services can buy or sell their desired services with complete freedom and awareness at the least cost and risk (Ansari Samani et al., 2017). The financial system can facilitate the financing of innovations in entrepreneurial businesses by providing specific functions such as facilitating payments, equipping

and allocating resources, and covering uncertainties (Kurpayanidi, 2021; Ansari Samani, and Alizadeh 2021).

Therefore, this study aims to investigate the impact of financial development on entrepreneurial activities between 2008 and 2018 in 44 developed and developing countries. The article is structured into five sections. The first section introduces the study. The second section covers the theoretical foundations. The third section provides background information from internal and external sources. The fourth section describes the model and variables used in the research. The final section presents the model estimation and conclusions.

## **2. Conceptual Framework**

Entrepreneurship is the process of introducing new products to the market, which leads to business success and the creation of new jobs in the economy. Innovative and creative ideas, along with capital, are essential for entrepreneurship (Baumol, 2002; Ansari Samani et al., 2022). Various definitions of entrepreneurship share a common behavior characterized by initiative, risk-taking, and the reform of socio-economic mechanisms to turn benefits and opportunities into special profit. The Global Entrepreneurship Monitor (GEM) report defines entrepreneurship as any attempt to create or manage a new business or to develop an existing business by an individual, group, or organization (Baumol, 1996).

Several factors can influence the quantity and quality of entrepreneurial activities in countries, including financial factors, organizational factors, economic framework, and conditions (Fasano et al., 2020). Financial factors, especially in the early stages of entrepreneurship, play a crucial role, and the lack of these resources has been identified as a significant obstacle for entrepreneurs (Pan and Yang, 2019). For instance, the lack of financial resources has been cited as a major impediment to entrepreneurship in 20% of entrepreneurial activities in the GEM report. The development of the

financial system is one of the essential processes to reduce the financing costs of entrepreneurs, and it is responsible for financing entrepreneurs as its primary task (Gozgor, 2018).

Financial development refers to the situation where financial institutions provide an increased range of financial services, and all members of society benefit from a wide selection of services. It can be understood as the integration of fragmented financial markets, where firms and households are highly isolated and face different effective prices for financial services (Bilir et al., 2019). In an efficient financial system, capital is transferred from savers to borrowers at the lowest possible cost and in the shortest possible time. Resources are directed towards productive and profitable investment projects, making the development of the financial sector crucial for equipping financial resources for investment and optimizing the mechanism of resource allocation (Allen and Qian, 2018).

In developed financial markets, entrepreneurial companies can obtain the financial resources they require from external sources, including issuing shares and borrowing from outside the company at the lowest cost. The financial system can facilitate innovation in entrepreneurial businesses by providing specific functions such as facilitating payments, equipping and allocating resources, and covering uncertainties. It also offers low-cost access to financial instruments, services, markets, and financial intermediaries (Mills, 2019).

Research conducted by Clapper et al. on financial development and its impact on entrepreneurship indicates that private and commercial credit are critical to market entry, and a lack of these credit opportunities is a significant obstacle to starting new firms and developing existing ones (Klapper and Love, 2011; Omri, 2020). According to Stiglitz, financial markets play an important role in the growth and development of any country's economy. Financial markets are considered the brain of the economic system and the primary

center of decision-making. If these markets fail, the entire economic system's functioning will be affected (Stiglitz, 1985).

Financial development is accompanied by innovation in the creation of new financial instruments that increase the financing capacity of entrepreneurs. This innovation contributes significantly to the growth and survival of entrepreneurial companies. Access to financial resources, especially venture capital, is essential in these innovations (Buera and Kaboski, 2011). Developed and developing countries face similar challenges in the face of external and internal barriers to the development of entrepreneurial and innovative activities. Insufficient capital for the rapid growth of enterprises through innovation is the most significant external constraint for many businesses in these countries (Thai and Turkina, 2014). Capital is available, but activating passive capital in the market, promoting a culture of risk-taking among investors, and increasing the level of readiness among entrepreneurs are crucial issues in using these funds to encourage innovative activities. The financial system plays an important role in addressing these challenges. Financial markets can coordinate investments to invest in innovative technologies (Ghasemzadeh et al., 2020). By providing the necessary capital to entrepreneurs, financial markets can help grow technology and commercialize their ideas, while also incentivizing investments in these opportunities (Kurpayanidi, 2021). Financial markets also have a strong oversight role that is often more effective than many bureaucratic oversight organizations. By disseminating information, encouraging successful companies, and penalizing loss-making companies, financial markets play a crucial role in monitoring and regulating economic activities (Wallmeroth et al., 2018).

### **3. Research Background**

In a study conducted by Dutta and Meierrieks (2021), the effect of financial development on entrepreneurship was investigated. The

results indicated that higher levels of financial development lead to higher levels of entrepreneurial activity, particularly when economic and political institutions are strong. The findings suggest that financial development contributes positively to entrepreneurial activity by meeting the demand for accessible, affordable, and extensive credit from entrepreneurs, as well as the demand for efficient and cost-effective risk and information management from investors.

Jiang et al. (2019) examined the impact of the inclusive financial development index on farmer entrepreneurship in 22 provinces and four municipalities in China from 2004 to 2017. The results showed that there are differences in the level of inclusive financial development across various provinces in China. Improving the level of inclusive finance can better promote farmers' entrepreneurship. The level of urbanization, economic openness, and regional economic development had a significant positive effect on farmers' entrepreneurship, while farmers' income and education level had a significant negative effect on farmers' entrepreneurship.

Zobeiri (2016) examines political risk, institutions and entrepreneurship in 45 developing and developed countries between 2008 and 2015. Among the factors affecting entrepreneurship, the emphasis of this research has been on the explanatory variable of political risk and institutional variables affecting entrepreneurship. For this purpose, using the studies of Dohan and Henrekson (2007) and Fontal Saz et al. (2015) and applying the panel data method, various specification of models with dependent variables of entrepreneurial opportunity and entrepreneurial necessity have been estimated. The results show that political risk has a negative and significant effect on entrepreneurial opportunity while this variable has a positive and significant effect on the need for entrepreneurship.

Kiani Nejad (2015) in a study has analyzed the dimensions and methods of funding sources in the development of entrepreneurial businesses. According to the results, by developing markets and

promoting financial instruments, we will be able to provide a variety of financial resources for entrepreneurs and small business owners in the early stages and growth of start-ups. As the breadth of resources and the right of entrepreneurs to choose increase, they will be able to overcome financial problems more easily than in the past through executive solutions. This reduces the associated risks and allows you to select resources at the lowest cost. Each of these resources has its own advantages and disadvantages, that entrepreneurs must choose the optimal option by considering the conditions and costs as well as the feasibility of each of them.

Pan and Yang (2019) have examined the effects of financial development on entrepreneurs and start-ups in China. The research data covers more than 5,000 startups that take into account the geographical features of startup cities and the role of financial resources in promoting start-ups. According to the results, the economic supports is beneficial both in providing stock and credit for the development of the start-ups in the country. Also, the availability of investment has a very positive effects on entrepreneurial activities in a city. The presence of start-ups in financial centers and neighboring areas in metropolitan cities where financial, political and technological resources are located, has a very positive relationship with entrepreneurial activity (Pan and Yang, 2019).

Ghorbani and Cheratian (2015) examined the relationship between women's entrepreneurship and monetary and fiscal policies of 12 countries in the period 2002-2007 using panel data. The results show that model indicators (economic growth, monetary policy and fiscal policy) have positive and significant effects on women's entrepreneurship. The experiences of some countries indicate the role of developing and promotion of women' knowledge in small businesses and entrepreneurs. It also includes consulting and training services in the areas of how to finance, manage, and market, and the use of the Internet and other services.

Abiad et al. (2008) by using financial liberalization index and organizational data for five emerging markets: India, Jordan, Korea, Malaysia, and Thailand, argue that financial liberalization is closely related to improved allocation efficiency, but financial deepening is less associated with allocation efficiency. On the other hand, financial liberalization is related to reducing the role of government and increasing the role of markets. Financial deepening is also related to increasing the volume of financial activities, and is mainly measured by indicators such as M2, private sector credit, and stock market capitalization relative to GDP. Although the two are related, they are not equivalent (Abiad et al., 2008).

Research Background has examined the main factors affecting entrepreneurship in previous research. Accordingly, the application of decentralized private sector entrepreneurship strategy has an effective role in unleashing the creative talents of citizens. The main factors that can determine entrepreneurship are: Financial factors, organizational factors, framework and economic conditions. Financial factors, especially in the early stages of entrepreneurship, play an important role and the lack of these resources is one of the main obstacles for an entrepreneur. There are different methods of financing through the banking system and money and capital markets, But the important point in this regard is the reduction of financing costs, ease of access, advantages and disadvantages of various sources. Financial liberalization improves allocation efficiency, reduces the role of government, and increases the role of markets. One of the relatively new and innovative options is venture capital financing. In this method, financing is accompanied by providing advice and playing a role in managing and running the business, especially at the beginning of entering entrepreneurship. Among other factors affecting entrepreneurship are geographical features, investment availability, access to financial centers and neighboring areas, transaction costs, execution of contracts, security of property rights and protection of



investment. A review of the research background showed that research on the factors affecting entrepreneurship has been done so far, but so far no research has been done to examine the role of financial development on the business and entrepreneurship entry index. Therefore, this research has innovations in the field of entrepreneurship.

#### **4. Research Method**

In this study, Quantile Regression has been used to investigate the impact of financial development on entrepreneurship. In order to more accurately study the relationships between variables, quantile regression provides a model that allows the study of the not only in the mean but in all parts of this variable and especially in the initial and final sequences. In this model, there is no limitation relating to the basic assumptions of OLS regression such as variance heterogeneity and the effects of remote data on coefficients are controllable. In quantile regression, unlike conventional regression, the minimization of the absolute value of the weighted residuals is used to estimate the pattern parameter, which is called the least absolute deviations (LAD) method.

#### **Model**

In this research, the following statistical model is used to investigate the relationship between the studied variables.

$$ENT_{it} = \alpha_0 + \alpha_1 FINDEV_{it} + \alpha_2 INSQUA_{it} + \alpha_3 GDPPC_{it} + \alpha_4 INF_{it} + u_{it}$$

$$u_{it} = \mu_i + \lambda_t + v_{it}$$

The main purpose or main hypothesis of this study is to investigate the impact of financial development on entrepreneurship in selected countries based on the above statistical model. The model used is derived from Kar, and ÖZŞAHİN (2016). In this model,  $i$  represents the country number;  $t$  represents the time;  $ENT$  represents the entrepreneurship index, which includes the three dimensions of entrepreneurial tendencies, entrepreneurial abilities and

entrepreneurial tendencies; INSQUA is a vector of the variables of the institutional status of the country in question, which include political openness, trade openness, political risk, and so on. FINDEV represents financial factors affecting financial development; GDPPC is the per capita GDP index; and INF indicate inflation rate as an indicator of macroeconomic status. The spatial territory of this study includes 44 countries: Argentina, Australia, Austria, Brazil, Belgium, Chile, Colombia, Czech Republic, Finland, France, Germany, Hungary, Indonesia, India, Iran, Ireland, Italy, Israel, Japan, Kazakhstan, Jordan, South Korea, Luxembourg, Malaysia, Mexico, Namibia, Hong Kong, Oman, Pakistan, Qatar, Russia, Peru, Poland, Philippines, Saudi Arabia, South Africa, Switzerland, Thailand, Turkey, UAE, UK, USA, Nigeria, and Morocco. The data used in this study were collected from the World Development Indicators, Organization for Economic Co-operation and Development, Global Entrepreneurship Monitor, and Transparency International.

### **Dependent Variable**

In this study, the dependent variable is the entrepreneurship index, which is explained by the registration of a new business per thousand people between the ages of 15 and 64, which shows the “flow” of entry into entrepreneurial activities in the official private sector of each country. The data was collected from World Bank Development Indicators and a new Entrepreneurship Database methodology created by Klapper and Love (2011).

### **Independent Variables**

In this study, two variables have been used as indicators of financial development of countries: the ratio of private sector credit to GDP and the ratio of capital market to GDP.

According to the FINDEV model, as an indicator of the development of the financial sector of the economy is representative of the financial factors affecting the development of banks and stock

markets? The ratio of private sector credit to GDP refers to the financial resources provided to the private sector by financial companies, such as loans, indirect securities purchases, trade credits, and other accounts receivable.

### **Control Variables**

The control variables studied in this study include institutional status, per capita GDP, and inflation rate. INSQUA Institutional quality coefficient is a vector of the variables concerning the institutional status of the country in question which includes perception of corruption, control of corruption, and political stability. This index is collected from the International Risk Guidance Reports, which publishes annual data on the surveyed countries.

The Corruption Perceptions Index is an index published annually by Transparency International since 1995. The Corruption Perceptions Index generally defines corruption as the abuse of public power for private gain. The index currently ranks 176 countries on a scale of 100 (very clean) to 0 (very corrupt).

Corruption control as a second indicator of the institutional status is derived from the World Bank governance indicators, which has a numerical scale from -2.5 to +2.5. This index shows how the use of public power for personal gain is controlled in both small and large forms of corruption. It also examines the "seizure" of the state by the elites and their private interests.

The index of political stability and non-violence is part of the indicators of global sovereignty that measure the likelihood of the government using illegal or violent means such as political violence and terrorism, political instability, overthrow of the government, and so on. This index is also part of the Food and Agriculture Organization.

GDPPC represents the GDP per capita index. This index is calculated annually at market prices based on the local currency of

each country. Data for this variable are extracted from the World Bank and the National Accounts of the Organization for Economic Co-operation and Development (OECD) based on the United States Fixed Dollar (2010).

INF represents the rate of inflation and as an indicator of the state of the macroeconomy under study. Inflation is an indicator of price changes over a period of time as measured by a consumer price index. The Laspeyres formula is usually used to measure this index. The data for this index are collected from the International Monetary Fund, the Financial Statistics Yearbook, and the World Bank data files.

## 5. Results

The results of model estimation using Quantile Methods are shown in Table 1. The two indicators for financial development are the capital market to GDP and the credits of the private sector to GDP, for which three separate estimates have been made. In each estimation, one of the three control variables which includes Perceptions of corruption, corruption control, and political stability are presented along with the two variables of inflation and GDP per capita. Following is a graph of each estimation as a pair with similar control variables for each financial development indicator.

**Table 1.** Results of Model Estimation by Quantile Method

Variables Models	Private Sector Credits to GDP	Capital market to GDP	Private sector credits to GDP	Capital market to GDP	Private sector credits to GDP	Capital market to GDP
Financial Development Index	0.02469 (0.002) <sup>***</sup>	0.646 E-7 (0.379) <sup>***</sup>	0.02412 (0.002) <sup>***</sup>	0.651 E-7 (0.372) <sup>***</sup>	0.0276 (0.000) <sup>***</sup>	0.522 E-7 (0.494) <sup>***</sup>
Perception of Corruption	0.01 (0.339) <sup>**</sup>	0.0245 (0.006) <sup>***</sup>				
Corruption Control			0.268 -0.229	0.523 (0.007) <sup>***</sup>		
Political Stability					-0.0656 (0.497) <sup>***</sup>	0.1926 0
Inflation Rate	0.01592 (0.315) <sup>**</sup>	0.0087 (0.515) <sup>**</sup>	0.01533 (0.000) <sup>**</sup>	0.0065 (0.619) <sup>**</sup>	0.00948 (0.543) <sup>**</sup>	-0.00077 (0.954) <sup>**</sup>
GDP Per Capita	0.331 E-04 (0.001) <sup>***</sup>	0.407 E-04 (0.0) <sup>***</sup>	0.321 E-04 (0.002) <sup>***</sup>	0.403 E-04 (0.000) <sup>***</sup>	0.403 E-04 (0.000) <sup>***</sup>	0.523 E-04 (0.000) <sup>***</sup>
R <sup>2</sup>	0.1816	0.1915	0.1921	0.2231	0.2351	0.2051
Adjusted R <sup>2</sup>	0.1726	0.1767	0.1755	0.2011	0.2071	0.1967
F	21.354	21.541	20.115	18.14	29.31	24.11

Variables Models	Private Sector Credits to GDP	Capital market to GDP	Private sector credits to GDP	Capital market to GDP	Private sector credits to GDP	Capital market to GDP
prob	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
equality of quantile slopes	38.25 (0.000)	34.12 (0.000)	42.15 (0.000)	46.19 (0.000)	44.19 (0.000)	49.91 (0.000)
assumption of symmetry	51.24 (0.000)	48.99 (0.000)	56.12 (0.000)	41.18 (0.000)	40.02 (0.000)	38.88 (0.000)

**Source:** Research finding.

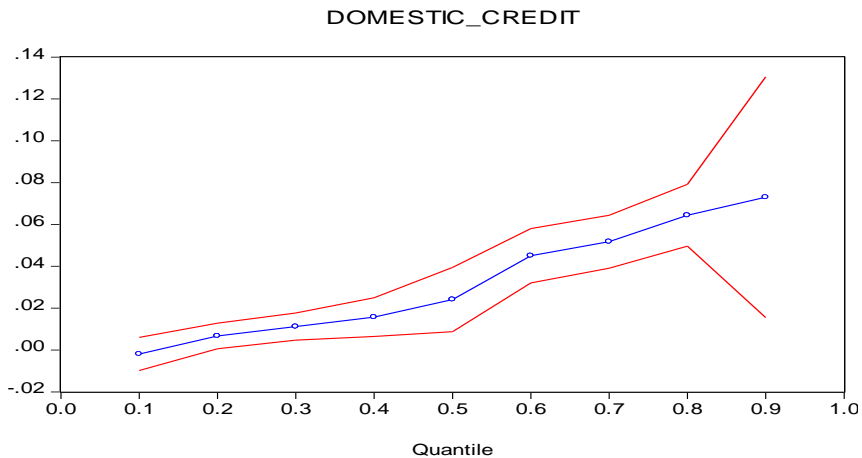
Figure 1 shows a quantile graph for the first and second assessments. Private sector credit to GDP and capital markets to GDP are considered as independent variables and perceptions of corruption, inflation and GDP per capita as control variables. The coefficients of the results indicate a positive relationship between private sector credit to GDP and the Entrepreneurship Entry Index, such that the coefficient's graph is ascending from the lower quintiles to the upper quintiles. The second index of financial development also has a positive relationship with the index of entering entrepreneurship. But unlike the previous chart, the capital market index relative to GDP chart is downward and decreases with moving to the upper quintiles. The results of these two indicators are in line with the research conducted by Mohammadzadeh et al. (2016) who have studied the role of economic freedom on entrepreneurship development, and indicate the facilitation of entrepreneurship by increasing credits and the role of capital market in financing Entrepreneurs. Corruption perception index coefficients are also positive for these two estimations, so that the better the perception of society is, the easier the path is for people to enter business. These results are in line with the findings of Palfka and Bonnie (2006), which examined the role of corruption in entrepreneurship in Brazil. Corruption destroys the motivation for entrepreneurship and disrupts all types of investments, such as investment in human capital.

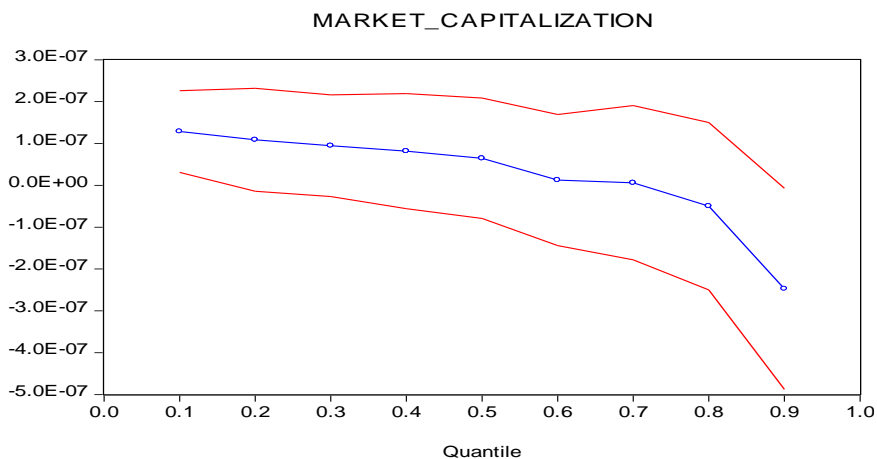
One way to identify the commonality of quantile slopes at multiple quantile levels is through hypothesis testing. Koenker (2005) described the Wald-type test through direct estimation of the

asymptotic covariance matrix of the quantile coefficient estimates at multiple quantiles. The Wald-type test can be used to test the equality of quantile slopes at a given set of quantile levels.

To check for the assumption of symmetry, we use Newey and Powell (1987) test. Thus, we can use the Wald test on the quantile process to evaluate the assumption of symmetry. The Wald test is designed with the null hypothesis of the symmetric effect. Indeed, refusing the null hypothesis of Newey and Powell (1987) test means refusing the assumption of symmetric values of the relationship over different quantiles.

Results of these test has presented in the table 1. Based on the results of the equality test of slope coefficients, it is possible to reject at a significant level of 5% the null hypothesis of this test that the slope coefficients are equal among the quantiles. In other words, the slope coefficients between the quantiles are not equal. Also, based on the results of the symmetry test, at a significance level of 5%, the zero hypothesis of symmetry of the coefficients in quantile regression is rejected. Because the probability of this test is less than 5%.

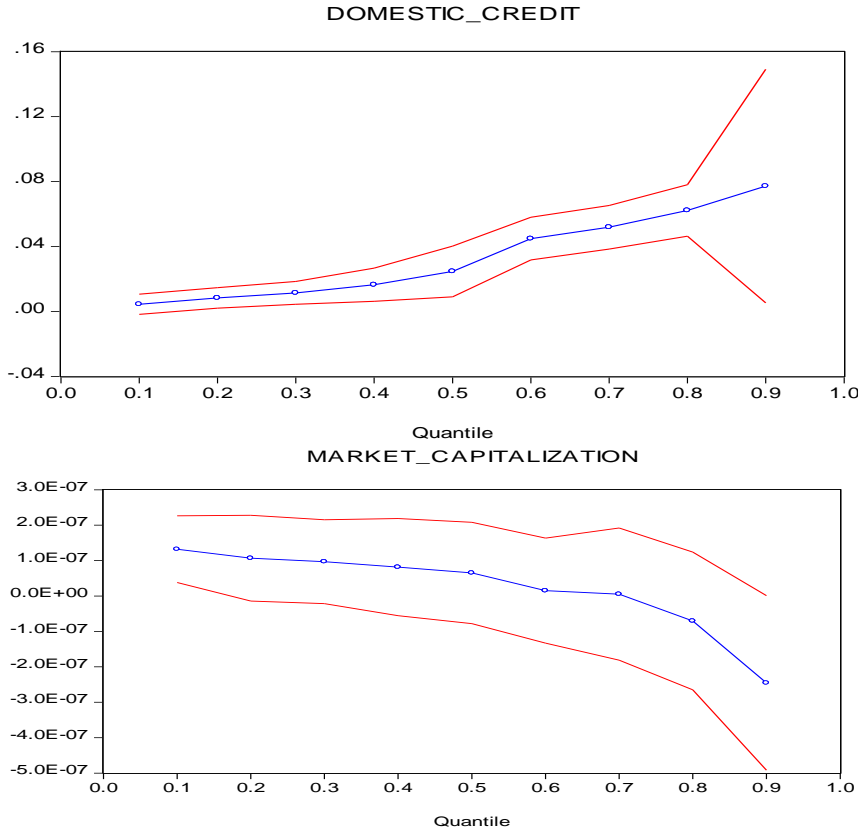




**Figure 1.** Quantile Estimation Diagram of the First and Second Assessments

**Source:** Research finding.

Following Table 1, the estimates of private sector credit ratios to GDP and capital markets to GDP are presented in the third and fourth assessments. Based on the estimation results as well as Figure 2, there is a positive relationship between private sector credit ratios to GDP and the Entrepreneurship Entry Index and the graph of its coefficients is ascending from the lower quantiles to the upper quantiles. Estimation of capital market coefficients relative to GDP as the second indicator of financial development also has a positive relationship with the Entrepreneurship Entry Index. Figure 2 shows that the value of the coefficients is descending and decreases by moving on the graph towards the upper quantiles. The results of these two estimations are in line with the results of Davari et al. (2018) who examined the role of business environment and entrepreneurial policies on entrepreneurship development. Additionally, the estimation of the corruption control variable is consistent with the results of Hanoteau (2001) who examined corruption and entrepreneurial activities, because in Hanoteau's research there is a positive and significant relationship between the characteristics of formal and informal institutions and entrepreneurship.

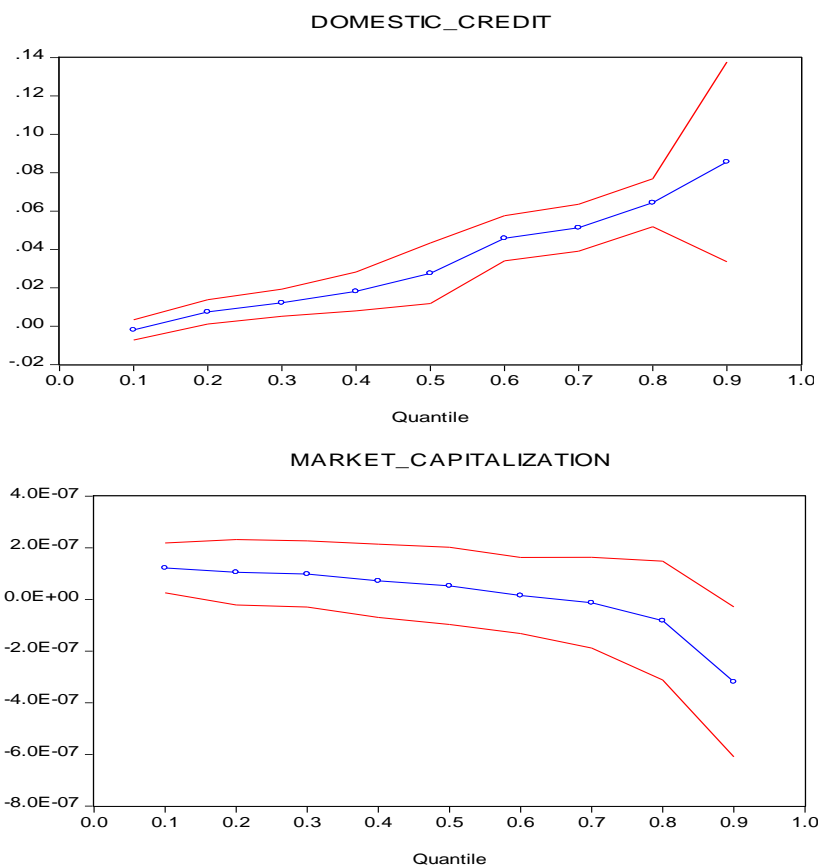


**Figure 2.** Quantile Estimation Diagram of the Third and Fourth Assessments  
**Source:** Research finding.

According to the results of Table 1 and Figure 3, the coefficients of private sector credit to GDP as the first indicator of financial development have a positive relationship with the entry to entrepreneurship index and the value of coefficients is ascending, such that by moving on the chart to the upper quantiles, its value increases. Capital market coefficients as a second indicator of financial development also have a positive relationship with the entrepreneurship entry index, but as shown in Figure 3, the value of the coefficients decreases by moving on the graph to the upper quantiles. These results are inconsistent with the findings of Amorós



et al. (2009), because their study shows that there is a significant negative relationship between economic development and entrepreneurship in 10 Latin American countries. Political stability coefficients are also negative for GDP for the private sector credit index and positive for GDP for the capital market index. These results are in line with the research of Asgharpour et al. (2013) which shows the negative impact of political instability on economic growth, it is inconsistent with the private sector credit index to GDP but is in line with the capital market index to GDP.



**Figure 3.** Quantile Estimation Diagram of the Fifth and Sixth Assessments

**Source:** Research finding.

## **6. Conclusion**

The main focus of this study is to investigate the role of financial development indicators and their impact on entrepreneurship as an index of business entry. The estimation results indicate a positive and significant relationship between financial development and entrepreneurship indicators. This is further confirmed by the quantile graph of each indicator. Previous studies have shown that private sector credit plays a crucial role in increasing entrepreneurship activities by providing smoother access to financing for entrepreneurs. Similarly, an increase in the volume of the capital market can provide long-term, lower-cost financing options for entrepreneurs and their businesses by attracting investment in financial markets and advancing capital market financial instruments.

To improve the necessary infrastructure and remove administrative restrictions that hinder entrepreneurial activities, it is essential to change the rules related to entering into entrepreneurial activities and provide the basic conditions for people to enter business and increase productive entrepreneurship in the country's economy. Indicators of financial development are crucial factors that should be taken into account. Improving these indicators can be one of the expected policies to enhance the business status and increase the role of productive entrepreneurs in the country's economy.

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