

## Global Financial Crisis and Its Effect on Entrepreneurship

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*The paper begins with the discussion about the 2008 global financial crisis which has deepened its roots all across the globe till date, while enlightening its causes and focusing on the question that how long will it prevail and to what extent the local SMEs will be affected. The onset of 2008 financial crises can safely be attributed to the collapse of USA and European housing markets, stimulated by sub-prime mortgage. Housing sector enjoyed boom across USA and Europe during 1998 to 2006. It has been stated that the worst part of the crisis is already over and the markets are suffering from what can be called 'the after shocks'. However, it is argued that normalization of economic activities need "global and semantic" solution; do it and you are out of it. Pakistan has very little foreign exchange left for its disposal and rumors are that the country is at the brink of bankruptcy. Entrepreneurs are affected in large and the crisis has curtailed their access to credit with a higher cost. Similarly, cuts are predicted in R&D, tradeshows, business tours. Therefore, it's the time that the Government of Pakistan have to act as a; Regulator, Insurer, Investor, and Lender for SMEs.*

**Field of Research:** International Finance.

### 1. Introduction

The paper has conducted a commentary on the discussion of the Global Financial Crisis and its multidimensional impacts include its severe impacts on Entrepreneurs. As Nicholson (2008) acknowledged that financial crisis which instigated from USA has now become a global phenomenon. At present, not only in U.S but across Asia and Europe, stock exchanges crashed; collective losses of the London, Paris and Frankfurt markets alone amounted to more than 350 billion Dollars. Stock Exchange 100 index closed more than 323 points down in January 2008. Bogetic and Balling (2009) discussed this crisis apart from affecting the capitalist economies has distressed the Socialist economy like Russia as well; in May 2008 Russian stock market was fallen by 50% and the Russian central bank had to buy rouble in massive amount to prevent the severe falling against US Dollar.

About the cause of crisis, Bartlett (2008) said that crisis was started with the downfall of US sub-prime mortgage industry, the intensity of this collapse was significant; Mark-to-market losses on mortgage-backed securities, collateralized debt

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obligations, and related assets through March 2008 were approximate \$945 billion.” He further stated that it is “The largest financial loss in history”, as compared to Japan’s banking crisis in 1990 about \$780 billion, losses stemming from the Asian crisis of 1997-98 approx \$420 billion and the \$380 billion savings and loan crisis of U.S itself in 1986-95. Yilmaz (2008) charged U.S subprime mortgage industry to be the major reason of current global financial crisis, he also stated that the total loses estimated initially up to \$300 to \$600 billion are now considered to be around \$1 trillion.

While enlightening the factors that why this US sub-prime mortgage crisis turn into global banking crisis, Khatiwada and McGirr (2008) stated “Many of these sub-prime mortgages actually never made it on the balance sheets of the lending institutions that originated them”; and they were made attractive to foreign banks by high investment grading, “when sub-prime borrowers failed to repay their mortgages, the originating institution needed to finance the foreclosure with their own money, bringing the asset back on its balance sheet. This left many banks in a financially unviable situation, in a rather short, unmanageable timeframe”.

However Hyun-Soo (2008) argues that it was the “Trust Crisis” which caused this global predicament. Khandker (2011) believes that it was series of events which caused the crisis; it begins with the collapse of currencies in East Asia in 1997 and became edgy due to the financial crisis of Russia in 1998. Next, in USA was the “dot-com” stock collapse in 2001, and the final stroke was again in USA, when after a swift decline in housing prices and “rapid contraction in credit, it fell into recession. Rasmus (2008) has the same thoughts; he, while discussing the reasons of economic recession of U.S said “The ‘real’ ailments afflicting the US economy for more than a quarter-century now include sharply rising income inequality, a decades-long real pay freeze for 91 million non-supervisory workers, the accelerating collapse of the US postwar retirement and healthcare systems, the export of the US economy’s manufacturing base, the near-demise of its labor unions, the lack of full time permanent employment for 40 per cent of the workforce, the diversion of massive amounts of tax revenues to offshore shelters, the growing ineffectiveness of traditional monetary and fiscal policy, and the progressive decline of the US dollar in international markets.”

## 2. What Governments are doing?

Governments are providing support and doing what so ever they can to prevent their economical structure; US government injected \$800 billion in the economy to support the structure, UK government has announced a package of \$692 billion, European Union is about to start an economic recovery plan and IMF has called for minimum financial support of \$100 billion. Also on the research part, Davis and Karim (2008) suggested an “Early warning System” to cop better with such crisis; the proposed two models “Logit” as a global early warning system and “Signal Extraction” for country specific early warning system. Khandker (2011) believe that such bailout programs and other supporting packages from governments is like offering protection from a negative outcome which is more appropriate to be called as “moral hazard”; this trend could increase the possibility of future bad upshots.

*How long the crisis will prevail?* It is indeed very difficult to answer this question; Grigore and Mitori (2009) believes that it's the matter of confidence of investors, as long as it is restored, crisis will be over; but it cannot be done when we daily hear news about the abandonment of financial institutions, it needs some financial stability. Gurria (2008) hopes that the effective macroeconomic policies and vital financial reforms will turn down the heat and normal financial conditions as well as the growth rates will return to normal in 2009. Yilmaz (2008) acknowledged that the worst part of the crisis is already over and the markets are suffering from what can be called 'the after shocks'. Zukang & Panitchpakdi (2008) says that normalization of economic activities need "global and Symantec" solutions, he stated that current "global Economic Governance System" is derisory for the prevention of such crisis.

### **3. Effects on SMEs**

SME sector can play a significant role in the growth of the country; they serve by creating new job opportunities, and has the potential to respond to the changes in environment in the global context; "a well-developed SMEs sector is able to uphold macro-economic stability and growth" Gurria (2008). As a result of massive effects on the governments, various industries are also being infected particularly the Small and Medium size Enterprises because of their heavy dependence on the banks. Paulson and Townsend (2005) concluded that when point comes to a financial crisis, it means a "poorly functioning financial markets" this inadequate performance of financial markets can lead to the limited entry of new firms, low production in the firms on hand, and greater financial constraints form small and medium enterprises.

### **4. Entrepreneurship**

Entrepreneurship according to different contexts is defined differently by authors; Morrison (2006) defined entrepreneurship as forming and growing something valuable from virtually nothing; process starts from creating or grasping an opportunity, and then pursuing it. Heilbrunn (2005) defined entrepreneurship as a dynamic process involving opportunities, individuals, organizational contexts, risks, innovation and resources. Tiessen (1997) see this from a process viewpoint, entrepreneurship is applicable to organizations of all sizes and types. Entrepreneurs generate variety by exploiting opportunities, and creating new ventures

### **5. Entrepreneurs and Crisis**

Relationship of Entrepreneurship with financial crisis is particularly evident in case of Thailand's financial crisis of 1997-2001, Paulson et al., (2006) divided the general entrepreneurs into three groups, "Pre-crisis; crisis and Post-crisis businesses" and found that not only the business performances were affected during that period but also the 'crisis' and 'post-crisis' groups were less willing to start up a business with considerable capital.

Considering the role of Entrepreneurship in the crisis, Won-Gyu (2007) states that due to its ability of innovation and growth of investment, entrepreneurship is able to play a vital role in the current financial scenario by creating job opportunities and

economic growth. The status of entrepreneurs worldwide is that in U.S, U.K and most of the Europe, entrepreneurs usually rely on financing from banks; in Arab countries, family and friends are usually the primary source of finance. Discussion of the forum further went to the point that incentives and strong government support for entrepreneurs are needed to be provided, especially in the capitalist economies which is in difficult times (World economic forum, (World Economic Forum, 2008). Bartlett (2008) states that economic crisis and downturns provides good opportunities for medium sized enterprises; they can “undertake counter-cyclical moves that strengthen their competitive position; Lean enterprise campaigns; strategic acquisitions; hiring of talented employees released by downsizing companies” and etc; He further stated that current crisis offers the same opportunities.

However, small firms are facing tightened credit term in contemporary financial conditions; moreover the entrepreneurs are showing noteworthy concern about access over credit. American Express economic report for October highlighted that “63% of small businesses reported being impacted by tightening credit conditions” (110th Congress Committee on Small Business, 2008).

## 6. Conclusion

The paper concludes that due to substantial effects on the national economies, SMEs, along with other industries are facing a difficult time. Entrepreneurs who are being affected by this “credit crunch”; can play a vital role in economic growth. Although the world is suffering from the crisis which is unique in its nature; starting from the sub-prime mortgage industry of U.S and then spreading all over the world; yet the remedies are not impossible to implement nor to late. Governments are doing what so ever they can to prevent their financial institutes to fall and protect their economical structure. Other stakeholder like players in financial markets and major Multinational Corporation can play their role to compliments the efforts of the governments.

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