



# MARKET FAILURES VERSUS BUSINESS ENTREPRENEURSHIP: A CASE FOR THE ACHIEVEMENT OF SUSTAINABLE DEVELOPMENT IN COUNTY GOVERNMENTS IN KENYA

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## **Abstract**

*Devolution is a key pillar of the Constitution of Kenya because it seeks to bring governance closer to the people. The County Governments are now at the centre of dispersing political power and economic resources to Kenyans at the grassroots. The Principles that underpins devolution in Kenya are that County governments established under the Constitution shall have reliable sources of revenue to enable them govern and deliver services effectively. This article seeks to examine how the principles of entrepreneurship and the issue of market failures can be harnessed by county governments to improve the economic wellbeing of their citizens. Whereas environmental economists argue that market failures bring about environmental degradation, the available literature on entrepreneurship argues that business opportunities arise from market failures. On the other hand, environmental entrepreneurship details how entrepreneurs seize opportunities that arise from environmentally relevant market failures in order to succeed. Entrepreneurship literature analyses how environmentally relevant market failures may represent opportunities for the achievement of business profitability. This being the case, then businesses can use part of the profits earned for corporate social responsibility in order to reduce environmental degrading economic behaviours. With the increases in the quality of life and economic growth since the industrial revolution, there have been substantial negative effects on the natural environment which has diminished the sustainability of most economic*



*systems. This conceptual paper looks at the entrepreneurship as a concept that can be applied in the management of County Governments in Kenya in order to achieve sustainable development and improve the welfare of its citizens. The paper recommends that the administration of county governments in Kenya study the environmental failures in their areas of jurisdiction to institute studies on how these failures can be utilised as opportunities for the improvement of the economic wellbeing of the citizens. The entrepreneurship concept will therefore become quite handy in the said studies.*

*Keywords: Market Failures; Sustainability; Entrepreneurship; Social Welfare; Economic wellbeing*

## **INTRODUCTION**

A close look at the environmental and welfare economics theories one is made to conclude that market failures within the economic system would motivate environmentally degrading entrepreneurial behaviours. On the other hand, in order to encourage entrepreneurial action adopt activities that will help resolving environmental problems, there is need to introduce the concept of “user pays” (Pigou, 1932). The entrepreneurs’ behaviour arises due to the unique characteristics of most environmental resources which bring about obstructions to their efficient allocation. At times there are obstructions to the use of environmental resources which makes entrepreneurial action end up not protecting and preserving valuable environmental resources (Dorfman, 1993). Entrepreneurial literature addresses the market-equilibrium, imperfections and failures, however, it is yet to address how entrepreneurs can overcome environmentally relevant market failures thus the exploitation of opportunities arising thereof in order to decrease environmental degradation (Eckhardt & Shane, 2003).

Entrepreneurship can help resolve environmental problems in order to move global economic systems towards sustainability by exploiting opportunities inherent in environmentally relevant market failures (Dean & McMullen, 2007). In order for this to happen, there is need to closely scrutinise entrepreneurship and environmental economics literature to identify if how they can contribute to the field of entrepreneurship by: i) providing knowledge about the means by which entrepreneurs can exploit the economic opportunities presented by environmental market failures problems; ii) understanding the role played by environmentally relevant market failures in creating opportunities which may bring us closer to the theory of sustainable entrepreneurship which addresses the role entrepreneurs can play in creating a more environmentally and socially sustainable economy; iii) the presence of entrepreneurial opportunities that may be brought about by environmentally relevant market failures which will

correlate the said opportunities to the magnitude of the economic value lost due to environmental degradation; and iv) suggest a more proactive role to be played by entrepreneurs developing economic institutions that are necessary to overcome market failures. The application of environmental economics literature to entrepreneurship will further broaden the perception of the entrepreneurship field in regard to economic wellbeing (Dean & McMullen, 2007).

This article will be divided into two parts thus: Part one which will be used to review entrepreneurship, sustainable development, sustainable/environmental entrepreneurship; Part two which will deal with market failures and sustainable entrepreneurial opportunities that may arise thereof; and Part three which draw conclusions and recommendations for further research.

## **ENTREPRENEURSHIP AND SUSTAINABILITY**

Entrepreneurship is a scholarly field which seeks to understand how opportunities to bring into existence future goods and services are discovered or created, who exploits them, and which consequences arise from the exploitation of these resources (Venkataraman, 1997). The above definition focuses attention on opportunities that will need to be explored; the sources of availed by the identified opportunities; the agents to exploit the identified resources who are entrepreneurs; and the consequences that may arise from the exploitation of the opportunities. It is therefore clear that the definition puts entrepreneurship into a larger social context in order to allow for the development of a structured research agenda. The entrepreneurship consequences that arise include economic, psychological, social and environmental (Cohen & Winn, 2004).

Entrepreneurship can be categorised into five categories all of whom are profit-motivated thus utilise their unique information to their advantage (Dean & McMullen, 2007). They are as follows; i) Coasian: They create economic value from entrepreneurial opportunities that arise from the tragedy of the commons by developing and enforcing of property rights regimes in order to exclude the public from public goods. They are motivated by profits thus can resort to exploitation of other stakeholders in order to maximise profits; ii) Institutional: they exploit opportunities created by the lack of market exchange for environmental resources by reducing transaction costs through the establishment of economic institutions; iii) Market appropriating: They exploit the entrepreneurial opportunities created by monopoly power of incumbent firms; iv) Political: they exploit the entrepreneurial opportunities created by the existence of subsidies, taxes and other structural incentives by influencing relevant changes for their benefit; and v) Informational: they exploit opportunities that arise from imperfect information through the

discovery of knowledge regarding market supply and demand conditions, and enhancing customer knowledge of product or service attributes.

A look at definitions of each of the categories of entrepreneurs, each of the three aspects of sustainability as defined in the Brundtland Commission's report (WCED, 1987) is addressed. The Brundtland Commission briefly defines sustainable development as the ability to make development sustainable by meeting the needs of the present without compromising the ability of future generations to meet their own needs. The definition includes the consideration of life support systems and community as envisaged by the World Commission on Environment and Development which include; i) Nature: which refers to the social benefits resulting from environmental initiatives such as the reduction of pollution which increases the quality of life and population health, ii) Life support: which refers to the economic benefits accruing to the entrepreneur due to successfully venturing into a given activity, and iii) Community: which stands for the entrepreneurship's positive impact on social wealth/capital.

Combining the consequences of entrepreneurship with the WCED definition of sustainable development, sustainable entrepreneurship is defined as the examination of how opportunities to bring into existence future goods and services are discovered, created, and exploited, who exploits them and the consequences in regard to economic, psychological, social and environmental aspects (Cohen & Winn, 2004).

## **MARKET FAILURES AND ENTREPRENEURIAL OPPORTUNITIES**

There are generally five types of market failures although there has not been any underlying theoretical foundation that exists to suggest that these categories of market failures are mutually exclusive or collectively exhaustive (Tietenberg, 2000). The market failures arise from the existence of the: Inappropriate government interventions; Public goods; Imperfect information; Externalities; and Monopoly power. In the following paragraphs we discuss how each of the conditions come about, implication of each condition on environmental degradation, the opportunities that are created by the identified environmental degradation and how environmental entrepreneurs can overcome these to bring about sustainable development.

### **Externalities**

An externality can be described as: i) A cost or benefits arising from any activity which does not accrue to the person or organization carrying on the activity (Black, 1997) or ii) The effect of one individual's actions on the utility of another individual Cowen (1988). They can also be viewed as side effects associated with market transactions (Kahn, 1995). The incentives of economic actors are misaligned where externalities exist since the actors who are creating

external costs may not be incurring their consequences (Buchanan & Stubblebine, 1962). The prohibitive transaction costs therefore brings about the inefficient allocation of resources (Cole, 2000). The proper allocating of scarce resources is therefore hampered by the presence of transaction costs and unassigned property rights (Demsetz, 1966 & Sternberg, 1996) therefore, under conditions of defined property rights transactions to alleviate the externality are not completed because the cost of the transaction will exceed their benefits (Dahlman, 1979). An example is where the transaction costs may include the cost of proving that emissions from a given factory are actually causing harm, hiring professionals to write a contract or suing the creator of the externality. This may include bearing the opportunity costs associated with the time spent pursuing externality issues.

Institutional entrepreneurs who are self-interested profit-seeking actors will come in to establish or modify institutions to reduce transaction costs through the introduction of levies and charges/penalties (Dean & Pacheco, 2005). In so doing, they capture economic value and reduce environmental degradation. One of the functions of the county government assemblies is legislation (Section 8 of the County Governments Act, 2012). Revoking this role, the county assemblies can legislate specific regulations and laws according to whatever economic value they intend to bring about in their areas of jurisdiction. This action will lead to sustainable natural resource utilization thus improvement in economic sustainability.

### **Inappropriate government intervention**

Government intervention is considered inappropriate when it results into the improvement of the welfare of one group while negatively affecting that of the other group. Such action is referred to as Pareto inefficiency thus does not bring any improvement in the welfare of the people because it results into taking by the right hand and giving to the preferred section of the community through the left hand. The overall effect is therefore not economic development but redistribution of the same available cake. The common environmental examples where government intervention is considered inappropriate are in subsidies that support the extraction of natural resources. It is common knowledge that subsidies of one industry support that industry at the expense of others thus changes to the structure of subsidies creates economic opportunities. Inappropriate government intervention results from politicians and regulators who pursue their own political and economic self-interests rather than that of the public at large by implementing programs for which they do not bear the direct costs (Cole, 2000). This is why there is the need for oversight by the legislative arm of the government.

Environmental entrepreneurs can create economic opportunity and reduce environmental degradation by motivating the elimination of subsidies or incentives which cause environmental harm (Dean & McMullen, 2007). This can be done through lobbying to eliminate subsidies, taxes and other incentives therefore creating economic opportunities in substitute industries or technology. Alternatively entrepreneurs can employ political strategies to motivate incentives for more environmentally beneficial industries or technologies. By introducing environmentally beneficial industries or technologies entrepreneurs will create efficiency in the utilization of natural resources thus improving the sustainability of the economic system in question.

### **Public Goods**

Public goods are open to consumption by all individuals regardless of whether the said individual has paid for such use or not (Cowen, 1988). Inclusivity results from the absence of property rights or lack of the effective enforcement of property rights in cases where they exist in statutes. In the absence of property rights each individual has an incentive to exploit the resource as quickly as possible (Randall, 1993). The rush to exploit a given resource due to lack of property rights results in resource degradation due to misalignment in incentives which leads to the “tragedy of the commons” (Hardin, 1968). This is where common resources are overexploited thus causing environmental degradation.

Through both political and technological mechanisms entrepreneurs can translate public goods into excludable private ones which creates potential profitable opportunities (Dean & Pacheco, 2005). The political strategies to be used may involve motivating government agencies to implement or enforce property rights regimes which allow the efficient functioning of a market for public goods (Goldin, 1977). Provision of public goods can also be enabled by entrepreneurs through technological strategies which will seek to transform a good from non-excludability to excludability (Goldin, 1977). This can be done through the exclusion of freeloaders from using public goods by enabling their provision and allowing the enforcement (Furubotn & Pejovich, 1972). When the above happens, it leads to the improved natural resource utilization which in turn leads to the improvement in the sustainability of the economic system.

### **Monopoly Power**

This is characterized by a single sellers who dictate the prices that they will sell their goods. This implies that a monopolist has a tendency to maximize profits. They can therefore underprovide and over-charge goods which lead to market failure (Bator, 1958). Such situation results in a loss of consumer surplus that is greater than the monopolist economic profit or producer

surplus (Scherer & Ross, 1990). In such a situation, private benefits exceed social benefits leading to an opportunity-creating discrepancy. Monopoly power may also bring about environmental degradation in two ways as follows: i) they are unlikely to adopt new technologies and methods of production due to lack of competition thus a tendency to continue with environmentally destructive methods of production; an ii) due to overpricing the equilibrium quantity produced is less than it would otherwise be which serves to reduce the amount of environmental degradation in case of highly polluting industries (Dean & McMullen (2007).

The economic value that may be captured from the destruction of the monopoly power produces opportunities for entrepreneurs. The implication is that only customers willing to purchase at prices above the costs of production will remain in the market with the rest being captured by the entrepreneurs who break the monopoly of the incumbents. In cases where monopoly power is preventing the adoption of environmentally superior business, the dissolution of monopoly power can have substantial positive effects on the environment. Otherwise where the monopoly constraint of output is benefiting the environment, breaking monopoly power can lead to increased levels of pollution due to the increase in industry output. Entrepreneurs who overcome monopoly power have substantial opportunity to profit from implementing renewable energy and use of current technologies in the process of reducing environmental impacts.

### **Imperfect information**

With perfect knowledge sellers and buyers have the information that is possibly available to enable accurate decision making. In the event of imperfect knowledge then decisions made may not be right. Imperfect knowledge therefore implies lack of knowledge regarding the latest production methods and resource availability. The nature of present and future markets will also not be known. The nature of imperfect information can be divided into: i) *Producer focused information*: where the knowledge that producers have about supply and demand conditions is not correct; and ii) *Customer focused information*: where the knowledge that customers possess regarding the nature of product or service attributes is wrong (Cowen, 1988).

### ***Producer focused information***

Not all producers are privy to the information regarding customer needs and preferences, product technologies, process technologies and sources of inputs because it is not readily available to them either intentionally or by default. In such scenarios you find that individuals are bombarded with new information to discover and interpret regarding changes in technology, social tastes and demographics which continuously alter the competitive landscape. Information content is therefore not clear which leads to disparate interpretations thus creating

imperfections. Only alert entrepreneurs may perceive what is happening otherwise the imperfection will persist (Leibenstein, 1968, 1979). Persistent imperfection in information leads to unutilized production possibilities which create entrepreneurial opportunities. The opportunities are then likely to remain until they are discovered by entrepreneurial action. In economies where trade associations are encourage such imperfect information may not be in existence (Oribu, King'oriah, & Agwata, 2014)

Environmental degradation arises in the advent of imperfect information among producers and potential producers. This happens when either environmentally superior means of supply are unknown or markets for environmentally superior products are undiscovered (Sarasvathy *et al.*, 2003). In such scenario, opportunities for entrepreneurs exist to: i) discover and implement new product or process technologies or other means of supply which are less environmentally damaging; ii) discover customers who prefer environmentally superior products and services (Reinhardt, 1999). In order to reduce environmental degradation there is need to discover methods of production which reduce environmental degradation or by marketing environmentally superior products to new market niches that value environmental protection activities. The respective entrepreneurs will then be able to capture economic value thus leading to a sustainable economic system.

Section 90 Of the County Governments Act (CGA, 2012) requires that county governments may conduct local referendum on: i) county laws and petitions; ii) planning and investment decisions affecting the county. If such a procedure in law is followed, then county governments will be in a better position to avoid imperfect information on specific projects that it intend to start to improve the economic wellbeing of the people.

### ***Customer focused information***

Under this category the customer lacks knowledge regarding the nature of product or service attributes. This prevents the markets from rewarding socially desirable economic behaviours due to the imperfect information regarding product or service attributes (Akerlof, 1970). Information sharing will enable actors in a given ecosystem to understand how other stakeholders will be affected by their actions which will prompt the aggressor to do something in mitigation (Oribu, 2014d). Entrepreneurs who enhance customer information regarding product or service attributes may get an opportunity to improve their businesses. Imperfect information at the hands of customers can contribute to environmental degradation. This is because customers lack information on the environmental impacts of products or associated production processes which may prevent them from purchasing products that they might otherwise desire. Keen entrepreneurs will capture opportunities by informing customers regarding the



environmental attributes of products and services. This enables the said entrepreneur to capture economic value which leads to a sustainable economic system.

The constitution of Kenya stipulates that there be public participation in order for the citizens to be able to decide what they want done for them County Governments Act, 2012). If the modalities and platforms for citizen participation are established with proper structures, then the county government will be able to get the customer focused information from the ground. This will inform the kind of services, restrictions and ways in which public resources can be exploited for the benefit of the general public. Section 95 of the county governments Act (CGA, 2012) requires county governments to establish mechanisms to facilitate public communication and access to information in the form of media with the widest outreach in the country.

## **CONCLUSIONS AND RECOMMENDATIONS**

The paper has conceptualized that market failures are a source of unmet market demand which exist as a result of discrepancies between private and social costs. Since the environment consists of natural characteristics they are susceptible to market failure and degradation thus a substantial source of entrepreneurial opportunities. The county governments can then come in to exploit the potential opportunities by eliminating barriers to the efficient functioning of the markets through subsidies, tariffs and charges. The action of county governments to exploit market failures will move the economic states of the respective county towards efficient utilization of resources. This process will be made successful by embracing the requirement of public participation by the citizens which is a key requirement in the Constitution of Kenya. In the event that there are environmentally relevant market failures in any given county government, efficient exploitation will reduce the anticipated environmental impact and move the county closer to sustainability. In order to identify the various categories of market failures, county governments will need to engage researchers in the respective areas. This is because researchers can gain better understanding of the barriers to efficient utilization of natural resources in order to provide a foundation through which the county economic systems can achieve sustainable development.

## **SCOPE FOR FURTHER STUDIES**

It is recommended that further research be considered on how the above conceptual paper can be utilized to determine how specific governments can adopt the entrepreneurial tendencies in order to identify specific market failures in order to improve the wellbeing of their citizens. Further studies may also be undertaken to identify specific market failures in governments that can be utilized to benefit the communities in which they occur.

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