

# Entrepreneurship and Institutional Environment: Perspectives from the Review of Literature

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## Abstract

The present study reveals how entrepreneurship and institutional environment has been addressed in the past theoretically and empirically. Main premise is to provide a broad overview of the existing studies on entrepreneurship and institutional environment throughout the world; show its development and movement over the past decades and fuse its findings on the basis of the insights gained from the review of the related literature. A methodical search was conducted in the leading journals of entrepreneurship. A total of 103 articles and research papers were reviewed. This methodical literature review not only increases the lucidity of the available literature but unveils significant areas for future research as well.

**Keywords:** Entrepreneurship, Institutional environment.

## Introduction

One of the most reoccurring concept in the study of contemporary entrepreneurship is that ‘entrepreneurship is interdisciplinary’. As such it contains various approaches that can increase one’s understanding of the field (Gartner, 1990). One way to examine the diversity of entrepreneurship theory is with a “Schools of Thought” approach that divides entrepreneurship into specific activities which may be within a “micro” view or a “macro” view that address the conceptual nature of entrepreneurship.

### Micro view

The micro view of entrepreneurship examines the factors that are internal or specific to entrepreneurs and are part of the internal locus of control. The potential entrepreneur has the ability or the control to direct or adjust the outcome of each major influence in this view. There are three Schools of thought in this view; trait theory, venture opportunity theory and strategic formulation theory.

Entrepreneurial Trait School of Thought is grounded in the study of successful people who tend to exhibit similar characteristic that if copied, would increase success opportunities for the emulators. Factors like achievement, creativity, determination and technical knowledge have been seen mostly exhibited by successful entrepreneurs. There are bodies of work that focus on the personal characteristics and life experiences of entrepreneurs (Brockhause, 1982; Bird, 1993; McGrath, MacMillian & Scheinberg, 1998). Family development and educational incubation are also examined (Shaver and Scott 1991; Mitchell et al.2004). Katz (2003), Shepherd (2004) and Kuratko (2005) contend that new programmes and new educational developments are on the increase because they have been found to aid in entrepreneurial development. This reasoning promotes the belief that certain traits established and supported early in life will lead eventually to entrepreneurial success.

Venture Opportunity School of Thought focuses on the opportunity aspect of venture development. The search for idea sources, the development of concepts, and implementation of venture opportunities are the important interest areas. There are studies on how entrepreneurs identify and seize upon market opportunities (Amit, Muller & Cockburn, 1995; Shane, 2005). Creativity and market awareness are viewed as essential and developing the right idea at the right time for the right market niche is the key to entrepreneurial success (Kuratko, 2007).

The Strategic Formulation School of Thought to entrepreneurial theory emphasizes the planning process in successful venture development (Lyles et al.1993 and Duane Ireland, 2001). Ronstadt (1984) view strategic formulation as a leveraging of unique elements, unique markets, unique people, unique products or unique resources are identified, used, or constructed into effective venture formations. There are studies on factors that stimulate entrepreneurship within firms (Morris, Zahra & Schindehutte, 2000)

### Macro view

The macro view of entrepreneurship presents an array of factors that relate to external processes that are sometimes beyond the control of entrepreneur, for the factors exhibit a strong external locus of control point of

view for the success or failure of entrepreneurial ventures. There are three schools of thought in the macro view: environmental, financial/capital and displacement schools of thought (Kuratko and Hodgetts, 2007).

The Environmental School of Thought deals with the external factors that affect a potential entrepreneur's life styles. These can be either positive or negative forces in molding of entrepreneurial desires. The focus is on institutions, values and mores that group together, form a sociopolitical environment framework that strongly influence the development of entrepreneurs (Van de Ven, 1993).

The Financial /Capital School of Thought is based on the capital-seeking process. The search for seed and growth capital is the entire focus of this school (Brophy and Shulman, 1992; Erickson, 2002). Venture capital process is vital to an entrepreneur's development. This school of thought views the entire entrepreneurial venture from a financial management perspective.

Displacement School of Thought focuses on the negative side of group phenomena where someone feels "out of place" or is literally "displaced" from the group. This school of thought holds that the group hinders a person from advancing or eliminates certain critical factors needed for the person to advance. Due to such actions the frustrated individual will be projected into an entrepreneurial pursuit out of his or her own motivations to succeed (Kuratko and Hodgetts, 2007). Ronstadt (1984) posted that individuals will not pursue a venture unless they are prevented or displaced from doing other activities.

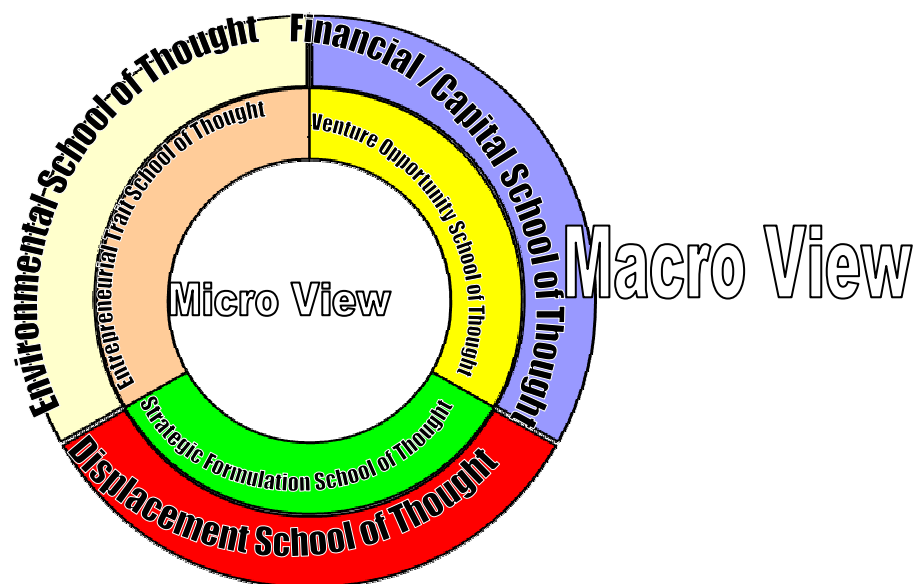


Fig. 1: Micro and Macro view of Entrepreneurial Environment.

In the present day practice on entrepreneurship, macro or contextual environment is considered to be more central in the entrepreneurship development of any economy. Furthermore, among the macro or external factors the institutional environment is said to have a significant impact on the entrepreneurship process of economies throughout the world. Institutional environment simply means an arrangement of institutions that forms a sociopolitical environment framework having strong influences on the development of entrepreneurs in any economy. For that reason, the focus here is on all the existing institutions in the economy and the network within and among these institutions.

All this construes that the institutional environment, in addition to other contextual factors, forms an important component of the macro or external environment for the overall entrepreneurship development in any economy. However, fewer studies have been undertaken on the institutional environment as one of the important constituents of the macro environment for entrepreneurship development, especially in developing countries. The literature is not also clear about the development and composition of an efficient institutional environment conducive to entrepreneurship development.

It is in this setting, that the present study to reveal how entrepreneurship and institutional environment has been addressed in the past theoretically and empirically is undertaken. The main premise is to provide a broad

overview of the existing studies on entrepreneurship and institutional environment throughout the world; show its development and movement over the past decades and fuse its findings on the basis of the insights gained from the review of the related literature.

### **Methodology**

A methodical search was conducted in the leading journals of entrepreneurship. A total of 103 articles and research papers were reviewed. The systematic review of the literature was undertaken purposely to make the scattered skimpy body of literature on institutional environment vis-a-vis entrepreneurship cogent and coherent and also unveil the significant areas for future research on this subject.

### **Review of literature**

Researchers point out that among macro or external factors that may impact the entrepreneurial environment are arrangements with and within institutions, the role of the government via legal, political, and economic politics and the country's social structure (Lowrey, 2003; Rodrik, 2007; Shane, 2003; Lundstrom and Stevenson, 2005). As such, environment is the aggregate and the dynamic interactions of those external factors which interact with the entrepreneur and the resultant organization and also among themselves to have impacts on the functioning of the venture. It encompasses the political, economic, legal, social, cultural, demographic, competitive, technological, physical, natural, ecological and all other environmental components. Conceptually it comes close to the 'constellation of forces' of Tripathi (1985).

There is strong evidence that environment plays a significant role in creation of an entrepreneurial venture (Hannan & Freeman, 1977). Environmental variables matter not only to provide opportunities to exploit the imperfect markets as argued in the approach advocated by economists, but also in the sense that different environments are more or less conducive for entrepreneurial activities to flourish ((Stevenson & Jarillo, 1990, van de Ven, 1993).

Thus if entrepreneurship is the individual's response to a situation, i.e. the environment around him, and creation of an organization is essential for carrying through that response: the entrepreneur, environment and the organization must be regarded as crucial elements of any framework relating to entrepreneurship. They are indispensably linked to and continuously influence one another at different stages of entrepreneurial development. There are complex, bi-directional, interwoven and dynamic causal relationships among these constructs where some may have dominant influences over others, depending on the stage in the life cycle of the entrepreneurial venture.

Van de Ven (1993) argues that the infrastructural environment comprising institutional arrangements and the public resource endowments facilitate as well as constrain individual entrepreneurs; it is both constructed and changed by them. Concepts such as circular flow, innovation clusters, creative destruction (Schumpeter, 1934), structural changes in industry, competitive environment, political and legal framework (Porter, 1980), are all linked with the environment, entrepreneurial choice and the organizational outcome.

Many countries are seeking to increase their entrepreneurial vitality in recognition of growing evidence that a high level of entrepreneurial activity, measured in terms of high business start-up and exit rates, contributes to economic growth and development. But how to strategically design and implement effective entrepreneurship policy measures is an inexact science at best. Research is currently being done to locate the importance of entrepreneurship in economic development and growth (Kirchhoff, 1994; Acs, Carlsson and Karlsson, 1999; Wennekers and Thurik, 1999; Reynolds et al., 1999, 2000; Audretsch and Thurik, 2001a, 2001b) and to prescribe what needs to be done to increase the level of entrepreneurial activity in a country (OECD, 1995; European Commission, 1998; Verheul et al., 2001; OECD, 2001). These works present all the compelling economic and social arguments why governments should be emphasizing business start-up rates and ease of firm entry and exit, and highlight the policy areas that need to be addressed.

Entrepreneurial activity responds to internal country factors 'Entrepreneurial Framework Conditions' (EFCs) and external factors 'General National Framework Conditions' (GNFCs) that intervene between the emergence and expansion of new firms (Bosma et al. 2008). Among the GNFCs, the Global Entrepreneurship Monitor (GEM) model includes external trade openness, the role of the government, market efficiency, technology intensity, physical infrastructure, management skills, labor market structure and institutional regulations. The EFCs that may affect the creation and development of new firms according to the GEM model, are financial support, government policies and programmes, education and training, research and development (R&D) transfer,

commercial and professional infrastructure, international market openness, access to physical infrastructure, cultural and social norms, and intellectual property rights protection. However, internal and external factors can positively or negatively influence the overall entrepreneurship activities depending on the interpersonal relationships of entrepreneurs (Hoang, and Antoncic 2003) and the inter organizational relationships between public and private institutions (Rodrik 2007). This supports Van de Ven's (1993) argument that studies are deficient if they focus exclusively on the characteristics and behavior of entrepreneurs without taking into account the environment and individual interaction.

Pages (2005), recommends an entrepreneur support system with "no wrong door"- every part of a region's small business support system network would be able to provide an initial assessment of the entrepreneur's skills and needs and identify the best place to provide the needed services. The system proposed by pages would link all relevant service providers, operate according to common procedures, and offer a customized and comprehensive set of public and private services for entrepreneurs. He contends that the business owners often receive the services available rather than the services needed.

This leads us to a general consensus that spatial conditions greatly influence new firm formation rates and that "the local social and economic milieu is the most important in fostering new firm formation." (Garofoli 1994, p.391). Accordingly attention needs to be given to spatial conditions that is context-specific (macro environment) aspects when studying entrepreneurship as these are likely to have an influence on the entrepreneurial process itself and entrepreneurial activity in the regions. Jill S. Taylor (2006) in his study 'what makes a region entrepreneurial?', identifies five areas in which policymakers can direct efforts to increase entrepreneurial activity in a region: human capital, financial capital, tax and regulatory climate, physical infrastructure, and business culture and entrepreneurial climate. The immediate environment and relations, for example, with family, networks and role models therefore have an important influence on entrepreneurial activity (Julien, 2007)

The primary responsibility in developing entrepreneurial environment and enforcing the legal and regulatory framework rests with the government. This can be achieved through apt policy initiatives and other specially designed programmes. On an average, experts across the GEM 2001 countries did not express satisfaction with government policy. Government policies in USA, UK, Finland, Ireland and Singapore were found to be the most favorable. In India, expert responses follow the general pattern, placing the country below the GEM 2001 average. Government policy is not seen as supporting new firms. The time and effort required to startup firms, to comply with regulatory obligations is a major issue (Doing Business- GEM, 2001).

Kayne (1999) claims, arguing that "states – through their laws, regulations, investments, and programs – have considerable impact on where entrepreneurs choose to establish new enterprises and the probability that those enterprises will succeed" (p.2). Van Looy, Debackers, and Audries (2003) argue that if governments can take supporting measures in the interest of a more favorable climate, a more "entrepreneurial" attitude is demanded of the knowledge centers and firms themselves.

GEM Report (2002) the government entrepreneurial programs that exist are not effective due to the lack of coordination between the agencies delivering them. The people working for government agencies are not considered to be competent. The result is that those that need help cannot find it. Government policies and programs are inconsistent and not administered efficiently. The legal framework is not effectively enforced. Regulatory requirements are not streamlined and cause a lot of stress to entrepreneurs. The overall assessment of the experts seems to be that entrepreneurial opportunities exist in India, and the people have the entrepreneurial capacity needed to realize the potential of these opportunities. In other words, the individuals and the economy are showing entrepreneurial readiness. Apparently it is society and government which are lagging behind. Social attitudes, lack of finance, inadequate physical infrastructure, and lack of effective government support emerge as the cause of concern. Initiatives for changing the current status of these dimensions can substantially improve the entrepreneurial environment and thereby the levels of entrepreneurial activity in India (GEM Report India, 2002)

Wennekers and Thurik (2001) and De (2001) suggest a role for government in stimulating cultural or social capital and creating the appropriate institutional framework at the country level to address the supply side of entrepreneurship, i.e., focusing on the number of people who have the motivation, the financial means and the skills to launch a new business. From the findings of their international benchmarking study of entrepreneurial activity, Reynolds et al. (1999) recommended that governments should focus their effort on creating a culture that validates and promotes entrepreneurship throughout society and develops a capacity within the population to recognize and pursue opportunity. They should target policies and programs specifically at the entrepreneurial

sector( rather than at aiming to improve the overall national business context), and to increase the overall education level of the population , specifically ensuring that entrepreneurship training is readily accessible to develop the skills and capabilities to start a business.

Thus in line with this, a variety of different policies / entrepreneurship models have been implemented by various governments throughout the world. Some models involve more direct involvement and greater expenditures on part of the government (e.g. strategic interventionism in Namibia) than do others (e.g. trade facilitation in Kenya). Some focus on infrastructure (e.g. (limited environmentalism adapted by western states of Austria) while others are based on credit policy (e.g., egalitarianism in Taiwan) while the top-down reform model (Yugoslavia & Germany) was designed for rapid, radical change; doi-moi (Vietnam)was designed to help small enterprises operate within a socialist system; subsidized interest rate model in south Korean; China has followed an open door policy coupled with major reforms of the completely planned economy which was formerly characteristic of the country a generation ago. The utilization of the open-door and reform model by china is consistent with Chinese culture .This suggests that a given model defining the government's role to promote entrepreneurship has to have a fit with the environment. An entrepreneurship model should not be transposed into a new environment, without verifying for appropriateness. This includes a variety of factors such as infrastructure, cultural values, and free trade agreements (Dana, 1992).

There are two distinct channels through which government policy impacts the rate of entrepreneurship. The first is through its impact on the quantity and quality of inputs going into the entrepreneurial process (education, venture capital, etc.). Targeted tax relief and/or direct government subsidies or regulations generally have their primary impact through this first channel. The second is through the impact of policy on the institutional structure that determines the 'rules of the game' under which the entrepreneurial process unfolds. These broad institutions together determine the incentive and reward structure faced by economic agents within an economy (Sarita Agrawal, 2009).

Baumol (1990) pioneered the role of institutions for entrepreneurial behavior, viz. how “the social structure of payoffs” channeled entrepreneurship to different activities – some of which are productive, some unproductive and some destructive/predatory. If institutions are such that it is beneficial for the individual to spend entrepreneurial effort on circumventing them, the individual will do so rather than benefiting from given institutions to reduce uncertainty and enhance contract and product quality. Baumol assumes that the supply of entrepreneurial effort in society is constant, so that the institutional setup only matters for its allocation across activities. This is one important aspect of the role of institutions, but the supply of entrepreneurial effort is also likely to be influenced by the institutional setup. If the institutional setting encourages behavior that is useful or productive from the societal point of view than higher levels of entrepreneurship would mean more prosperity for the society. There is a growing theoretical and empirical literature on the importance of institutional quality in explaining cross-country differences in growth (North, 1991; Hall and Jones, 1999; Gwartney, Holcombe and Lawson, 2004). While each of these studies measures institutions in a slightly different way, they all find evidence that countries with better institutions have higher levels and rates of growth than countries with poor economic institutions (Henrekson, 2007).

The effect of institutions on entrepreneurship was explored by looking more closely into four key institutions, namely the protection of private property rights, savings policies, taxation and the regulation of labour markets. The two most important conclusions from this analysis are that (i) institutions have far-reaching effects, and (ii) to identify these effects on productive entrepreneurship, the respective institutions have to be studied in depth. “Entrepreneurship cannot be studied without taking institutions into account. Entrepreneurs are always responsive to the incentives embedded in the environment in which they act, and they may even expend entrepreneurial effort to try to change the institutions” (Daokui Li et al. 2006). There are a number of additional institutions that are likely to be important determinants of the incentives for entrepreneurship, e.g., the regulation of product markets, start-up costs, the regulatory burden on firms, the social security system and cultural values vis-à-vis entrepreneurship.

### **Findings/Conclusion**

One most important finding from this analysis is that the institutional environment has a far-reaching impact on entrepreneurship development in any economy. Therefore the analyses of entrepreneurship should be conducted through the lens of the institutional environment setup also.



Given the important role of institutional environment in entrepreneurship development of any economy, there is a pressing need for more and more research studies on Institutional environment and its impact on the overall entrepreneurship development of economies throughout the world.

Furthermore, from the analysis one can safely infer that in spite of the fact that the institutional environment, in addition to other contextual factors, forms an important component of the macro environment for the overall entrepreneurship development in any economy, the literature on the impact of the institutional environment as one of the constituents of the macro environment for entrepreneurship development is very sparse, especially in developing countries. Particularly there are only scanty studies that explore the deficit of entrepreneurship from the perspective of institutional environment support. The literature is not also clear about the development and composition of an efficient institutional environment model conducive to entrepreneurship development,

Finally, all this review analysis brings to the fore a big call for future research on the subject of 'Entrepreneurship and Institutional Environment'.

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