The Relationship Between Entrepreneurship, Culture and Legal Rules

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Abstract
Entrepreneurs play a vital role in economic development as key contributors to technological innovation and new job growth. Further, entrepreneurs help build communities in ways such as providing jobs, conducting business locally, creating and participating in entrepreneurial networks, investing in community projects, and giving to local charities. Realizing both the economic and social impact of entrepreneurship, many states and local communities have implemented aggressive strategies aimed at cultivating and nurturing entrepreneurs. Schumpeter's canonical depiction of the entrepreneur as an agent of social and economic change implies that entrepreneurs are especially sensitive to the social environment. We extract teachings from several disciplines while adopting a primary perspective based on institutional economics to consider the social dimensions of entrepreneurship. The level and modes of entrepreneurial activity are affected by the surrounding culture and by legal rules. Entrepreneurs may partially overcome institutional deficiencies by relying on social networks that facilitate reputational bonding as a means for resource-sharing.
Keywords: Entrepreneurship, social institutions, culture, law, social networks, reputation.

INTRODUCTION

The capacity and willingness to develop, organize and manage a business venture along with any of its risks in order to make a profit. The most obvious example of entrepreneurship is the starting of new businesses. In economics, entrepreneurship combined with land, labor, natural resources and capital can produce profit. Entrepreneurial spirit is characterized by innovation and risk-taking, and is an essential part of a nation's ability to succeed in an ever changing and increasingly competitive global marketplace.

In a pioneering book chapter whose title foreshadowed the present chapter's theme, Shapero and Sokol (1982: 83) averred that '[t]he social and cultural factors that enter into the formation of entrepreneurial events are most felt through the formation of individual value systems. More specifically, in a social system that places a high value on the formation of new ventures, more individuals will choose that path …. More diffusely, a social system that places a high value on innovation, risk-taking, and independence is more likely to produce entrepreneurial events than a system with contrasting values.' Subsequent research reviewed in this chapter has largely vindicated Shapero and Sokol's proposition, although the interrelations between entrepreneurship and various social dimensions now seem more complex.

THE ENTREPRENEUR: AN INDIVIDUAL PORTRAIT

Some seventy years ago, Schumpeter (1934: 93-94), the patron saint of all entrepreneurs (Solow 1994), depicted the motives of the entrepreneur as follows:

First of all there is the dream and the will to found a private kingdom, usually, though not necessarily, also a dynasty. … Then there is the will to conquer: the impulse to fight, to prove oneself superior to others, to succeed for the sake, not of the fruits of success, but of success itself. From this aspect, economic action becomes akin to sport… The financial result is a secondary consideration, or, at all events, mainly valued as an index of success and as a symptom of victory, the displaying of which very often is more important as a motive of large expenditure than the wish for the consumers' goods themselves. … Finally, there is the joy of creating, of getting things done, or simply of exercising one's energy and ingenuity. ... Our type seeks out difficulties, changes in order to change, delights in ventures.

Romantic as it may seem at first glance, Schumpeter's portrait of entrepreneurial motives captures essential facets of entrepreneurship that mainstream economics still grapples with. Schumpeter's core contention, that entrepreneurs do not seek greater wealth for the sake of increasing consumption seems at odds with conventional depictions of economic agents. This seeming contradiction is all the more evident when one considers the alleged motives of 'the joy of creating… delights in venturing', which, one should bear in mind, are related to economic activity in the market, not recreation and leisure.

Recent evidence suggests, however, that Schumpeter might be right. Hamilton (2000) finds that in the United States, median entrepreneurs earnings after 10 years in business are 35 percent less than the predicted alternative wage on a paid job of the same duration. Hamilton's use of a self-selection model shows that it is not the case that low-ability workers become entrepreneurs; if anything, the evidence shows that higher-ability workers are more likely to enter into self-employment. Therefore, large-sample evidence amassed by Hamilton strongly suggests that self-employment offers substantial nonpecuniary benefits, such as 'being your own boss.' Moskowitz and Vissing-Jørgensen (2002) similarly find that entrepreneurs are willing to concentrate their investments in their own businesses despite the fact that they present a far worse risk-return tradeoff than investing in public equity. Kerins, J. Smith and R. Smith (2004), moreover, provide evidence on the very high cost-of-capital levels that entrepreneurs and venture capitalists are willing to bear to engage in entrepreneurial activity. The leading explanation for these results is based on nonpecuniary benefits from entrepreneurial activity. A further sociologically-based explanation is that high-ability individuals are culturally encouraged to start firms where family members can be employed and share directly in the profits. Further work is needed to test this hypothesis. Using Swedish data, Giannetti and Simonov (2003) do argue that social norms may drive people into entrepreneurship notwithstanding lower individual profits.

Amit et al. (2001) compared Canadian entrepreneurs with senior managers who decided not to start ventures in the high-technology sector. They found that for entrepreneurs' decision to start a new venture wealth attainment was significantly less important relative to an aggregate of ten other decision dimensions (specifically: vision, stability, power, lifestyle, leadership, innovation, independence, ego, contribution, and challenge). Several other studies maintain that entrepreneurs are more over-confident than regular people are and appear to be driven by wishful thinking (Bernardo and Welch 1998; Arabsheibani, de Meza, Maloney, and Pearson 2000; Cooper, Woo and Dunkelberg 1988). However, one would be wrong to interpret either Schumpeter or the evidence mentioned above as suggesting that entrepreneurs are agnostic or oblivious to financial considerations. Studies conducted in several countries show that individuals are sensitive to capital constraints in their decision to take entrepreneurial positions – in particular, self-employment.1

Several studies hold that entrepreneurs find special importance in their independence (Blanchflower and Oswald 1998; Blanchflower 2000; Blanchflower, Oswald and Stutzer 2001; Hundley 2001). Using survey data from the United Kingdom, Germany, and Switzerland, Benz and Frey (2004) argue that the greater independence and autonomy of self-employed persons is largely responsible for their particular job satisfaction. A series of recent studies on OECD-member nations further shows that people most often move into self-employment when they are dissatisfied with their life, and that the very act of creating their own business tends to make them more satisfied than the average person in their country (Hofstede 1998; Noorderhaven et al. 1999; Noorderhaven et al. 2003; Hofstede et al. 2004). Falter (2002) holds that the greater job satisfaction exhibited by the self-employed in Switzerland stems rather from their job characteristics than from income. Falter notes that this may be due to individual over-optimism in addition to greater freedom.

Taken together, the above evidence suggests that entrepreneurs are relatively more willing to forgo income and to bear costs, including through increased risk levels, in order to engage in independent ventures. These studies may have some methodological weaknesses, however. To be able to confirm that entrepreneurs have alternative options with higher income, one would need to replicate the exercise in Stern (2004), who collected data on scientists who give up more lucrative job offers to do real science at lower pay. Still, while the literature's lack of measurement on alternative options is a weak point, the preponderance of survey evidence from the entrepreneurship literature does still at least suggest that entrepreneurs often had more lucrative alternatives inside established firms (see Amit et al. 2001).

Compared with non-entrepreneurs, entrepreneurs behave as if they understand the present fairly well but have rather special views regarding the future. Yet the image of the entrepreneur reflected in these works is still very fragmented. A richer picture emerges when one considers insights from a psychological perspective. While the literature on entrepreneurship and individual-level psychology is voluminous and lies beyond the present scope,2 here we briefly note that entrepreneurs' risk propensity has been found to be non-distinguishable from that of non-entrepreneurs. Rather, entrepreneurs differ in their risk (under-)assessment, consistent with their general over-optimism (e.g., Palich and Babgy 1995; Sarasvathy, Simon and Lave 1998).

Researchers have developed a multi-dimensional construct of entrepreneurial orientation with three sub-dimensions: innovation, proactiveness, and risk-taking, and established its validity in several national samples (Miller 1983; Covin and Slevin 1989; 1991; Lumpkin and Dess 1996; Kreiser, Marino and Weaver 2002). These dimensions capture more elements of entrepreneurial motivations and behavior than other models do, thus bringing us closer to the model suggested by Schumpeter and other classic scholars (Knight 1921; Kirzner 1973). Importantly, these constructs lend themselves to examining the impact of national culture on entrepreneurship (Kreiser, Marino and Weaver 2002).

A notable feature of this branch of entrepreneurship literature, however, is the paucity of studies on the role of personal values in differentiating entrepreneurs from salary earners. Values are conceptions of the

[1] See Evans and Jovanovic (1989); Evans and Leighton (1989); Holtz-Eakin et al. (1994); Van Praag and Van Ophem (1995); Lindh and Ohlsson (1996); Blanchflower and Oswald (1998); Dunn and Holtz-Eakin 2000; Van Praag (2003).

[2] For a review see Rauch and Frese (2000). Wadeson (this volume) reviews the cognitive aspects of entrepreneurship concerning decision-making and attitudes to risk.

desirable – a motivational construct. They represent broad goals that apply across contexts and time (Rokeach 1973; Schwartz 1997; Schwartz and Bilsky 1987, 1990). Personal value emphases have been systematically related to individuals' behavior (e.g., Schwartz and Bardi 2003). Drawing on Rokeach's (1973) theory of values, Bird (1989) and Sarasvathy (2001) proposed that entrepreneurs' personal value emphases may distinguish them from other people. Having searched the business, economics, and finance sections of the JSTOR database and internet resources more limitedly, we are not aware of studies that tested this proposition empirically.

The Schwartz (1992) model of individual values defines ten broad values according to the motivation that underlies each of them (specifically: power, achievement, hedonism, stimulation, self-direction, universalism, benevolence, conformity, tradition, and security). These values are presumed to encompass the range of motivationally distinct values recognized across cultures. These values can further be organized along two bipolar dimensions: self-enhancement versus self-transcendence and conservation versus openness to change. This model appears to hold promise for a more systematic analysis of entrepreneurial orientations. The Schwartz (1992) model can be used to investigate reliably whether entrepreneurs indeed possess a distinct set of motivational preferences relative to their non-entrepreneur peers, as Schumpeter conjectured. We note, without elaboration, that a plausible hypothesis in this respect would be that entrepreneurs' value priorities will emphasize self-enhancement and openness to change over self-transcendence and conservation, respectively.

ENTREPRENEURSHIP AND SOCIAL INSTITUTIONS

The richness of entrepreneurial motivations suggests quite clearly that entrepreneurial behavior responds to an equally rich set of cues from the social environment. Indeed, because entrepreneurial activity is especially sensitive to non-pecuniary incentives one may assume that entrepreneurship will be associated with distinct social dimensions—more than, say, faceless spot market transactions in commodities. Entrepreneurs—like all economic agents for that matter—operate in concrete social institutional settings, namely, against written and unwritten 'rules of the game': laws, norms, beliefs, etc. (North 1990). Among other things, these social institutions affect the perceptions of desirability and feasibility of entrepreneurial events postulated by Shapero and Sokol (1982). These institutions also affect monetary and non-monetary transaction costs for entrepreneurial activity (cf. Hayton, George and Zahra 2002).

Research on the social dimensions of entrepreneurship has made considerable progress since Shapero and Sokol (1982). While these scholars drew primarily on research in sociology and anthropology (focusing especially on minority and immigrant communities[1]), current research employs a variety of disciplinary approaches. The predominant analytical framework, however, is Hofstede's (1980, 2001) theory and dataset on cultural value dimensions (Hayton, George and Zahra 2002). In addition, other, less capacious, institutions also play a pivotal role in entrepreneurial activity. To organize the discussion, we adopt an institutional economics approach drawing on Williamson's (2000) framework for institutional analysis.

Williamson's model distinguishes four levels of analysis. 'Level 1' consists of informal institutions. This is where norms, customs, mores, and traditions are located and where religion plays a role. More generally, this is the level of culture. Level 2 consists of formal legal rules and regulations, comprising constitutions, law, property rights, etc. Governance structures and marginal analysis belong to Levels 3 and 4, respectively. The core assumption underlying this model is that in the long run, elements located in adjacent levels should be compatible with one another and likewise for specific institutions within each level. The following sections demonstrate how specific aspects of entrepreneurship relate to social institutions at various levels.

CULTURE AND ENTREPRENEURSHIP

It is now virtually undisputed in the entrepreneurship literature that culture bears a profound impact on all facets of entrepreneurship in societies (George and Zahra 2002). This scholastic consensus is consistent with the general importance accorded to culture in management studies but is not necessarily shared by some branches in economics. Hayton, George and Zahra (2002) provide a comprehensive review of empirical studies that have examined the association between national culture and entrepreneurship. A careful reading of these studies reveals, however, that this literature has some conceptual and methodological obstacles still to overcome. Instead of recounting Hayton, George and Zahra's (2002) review we concentrate on these basic issues and supplement this analysis with more recent evidence.

What is culture? Defined in subjective terms, culture refers to the complex of meanings, symbols, and assumptions about what is good or bad, legitimate or illegitimate that underlies the prevailing practices and norms in a society (Bourdieu 1972; Markus and Kitayama 1994). Often, culture is defined a set of shared values and beliefs (Hofstede 1980; 2001). A common postulate in cross-cultural psychology is that all societies confront similar basic issues or problems when they come to regulate human activity (Kluckhohn and Strodtbeck

[1] This chapter concentrates on country- or nation-level societies. Entrepreneurship among subcultures such as immigrants and minority groups is discussed in Basu (this volume).

1961). A society's culture reflects its response to these issues in certain cultural orientations. Such cultural orientations represent general societal stances that are deeply ingrained in the functioning of major societal institutions, in widespread practices, in symbols and traditions, and, through adaptation and socialization, in the values of individuals (Kluckhohn 1951; Hofstede 1980; Schwartz 1999). Cultural orientations are also associated with certain (personal) cognitive styles, leading scholars to consider cultures as 'systems of thought' (Nisbett et al. 2001; Peng, Ames and Knowles 2001).

A basic yet crucial point for understanding the social dimensions of entrepreneurship is that culture is a society-level phenomenon. The so-called 'ecological fallacy' occurs when one fails to acknowledge the distinction between the individual and society levels of analysis (Hofstede 1980; 2001). To see the level-of-analysis distinction in the present context, consider two iconic scholars: Weber (1904) and Schumpeter (1934). Weber's theory on the Protestant ethic related economic development to certain societal orientations, which Weber associated with Calvinism and Puritanism in particular. Among other things, these ethics emphasized the role of the individual in this world as a free soul seeking material wealth as evidence for being one of the chosen. Although Weber is often associated with entrepreneurship (e.g., Thomas and Mueller 2000), his theory was not explicitly directed toward entrepreneurship (Brouwer 2002). Crucially, Weber was interested in societal values, not in the individual entrepreneur's motivations. In contrast, Schumpeter's theory of entrepreneurial motivations, cited above, was entirely about individual motivations and did not postulate a societal ethic. Hence, Schumpeter (1934) cannot be considered 'a refutation of Weber's theory' (cf. Brouwer 2002, p. 85) because the two theories apply to different levels of analysis.

Studies avoiding the ecological fallacy have examined the proposition that certain individual features consistent with Schumpeterian-like entrepreneurship may be more common in certain national cultures. This is a plausible proposition, which essentially seeks to find traces of cultural orientations in personal traits. Without exception, researchers used Hofstede's four cultural value dimensions of individualism/collectivism, power distance, uncertainty avoidance, and masculinity/femininity.[1] Thus, Meuller and Thomas (2000) show that innovativeness and internal locus of control were more likely to be found among students coming from cultures high in individualism and low in uncertainty avoidance (see also Thomas and Mueller 2000).

These studies and earlier ones in a similar spirit (e.g., Shane (1994, 1995)) suggest that a particular cultural profile—in particular, high individualism and low uncertainty avoidance, which is characteristic of English-speaking countries and especially the United States—is especially conducive to entrepreneurship. Evidence mentioned below on legal institutions is consistent with this view. At present, however, it may be too early to reach such a conclusion. As a broad generalization, researchers tended to examine individual-level constructs and employed instruments that were developed in the United States (Kreiser, Marino and Weaver 2002). More work is needed to establish these elements' universality, as has been done with the Schwartz (1992) model of personal values or the 'Big Five' personality attributes (see Ciavarella et al. 2004; on cognition see Mitchell et al. 2000).

In the meanwhile, one cannot dismiss the notion that current studies may miss the value-creation function of certain personal traits not highlighted in the Schumpeterian template. Entrepreneurship a la Schumpeter and Kirzner involves motivation, cognition, and action, with possible mediators like intention (Krueger, Reilly and Carsrud 2000). The entrepreneur acts on what she perceives as a valuable opportunity, motivated by her special motivations. The Schumpeterian entrepreneur is usually portrayed as a quintessential model of Western agency: an autonomous individual striving against the mainstream to take advantage of his or her uniqueness.[2] Perhaps non-Western cultures encourage value-creation and innovation through other more collectivistic values.

A growing literature now holds that the Western notion of individual agency may not similarly apply in other cultures. Cultures known to value embeddedness over autonomy (or collectivism over individualism) have been found to be populated by individuals with a greater distaste for uniqueness and autonomous action (Menon et al. 1999; Markus and Kitayama 2003; Miller 2003). Furthermore, differences in how individuals frame and interpret events between Western and East Asian cultures (mostly U.S. versus China and Korea) have been linked to differences in the individualism/collectivism cultural dimension. While Westerners may attend more to specific items and persons, recent studies in this literature suggest that East Asians attend more to the field and the general context (Nisbett et al. 2001; Peng, Ames and Knowles 2001). Causal explanations relying on cultural differences are, without doubt, highly provocative, and more work is needed to verify their robustness (see Begley and Tan 2001; Morse et al. 1999; Mitchell et al. 2000). Needless to say, not all entrepreneurs from

[1] Hofstede's theory and the usefulness of his dataset, especially for contemporary empirical studies, have been criticized on various grounds, which we cannot address in the present scope. In our view, the Hofstede framework largely withstands the criticisms leveled against it.

[2] "Agency" here means "being agentic" as used in psychology. It should not connote the "agency problem" known in economics.

different cultures would exhibit these differences to the same degree. For example, many entrepreneurs from starkly different cultures would rank equally high in terms of their individual preference for autonomous action, and yet it is still possible that culture would lead to significant differences between entrepreneurial norms of behavior at the mean on these various cognitive dimensions.

Another line of research considers relations between cultural value dimensions and other individual-level factors related to entrepreneurship. According to Hofstede, low uncertainty avoidance 'implies a greater willingness to enter into unknown ventures' (2001, p. 164). Hayton, George and Zahra (2002) maintain that high individualism, high masculinity, low uncertainty avoidance, and low power distance are conducive to entrepreneurship. Nevertheless, the evidence is mixed. Using patent filings as a proxy for entrepreneurship, Shane (1993) finds support for most of the correlations hypothesized above. Morris, Avilla and Allen (1993), however, argue for a curvilinear relation between individualism/collectivism and corporate entrepreneurship. Studies find that business ownership correlates positively with uncertainty avoidance and with power distance, but not with individualism. In support of Hofstede et al.'s (2004) theory, these empirical findings underline the idea that a climate of high uncertainty avoidance in large organizations pushes enterprising individuals to go out and create their own businesses (Wennekers et al. 2002; Noorderhaven et al. 2002; Noorderhaven et al. 2003).

Brief mention should be made of two studies that employ a materialism/post-materialism value dimension derived from Inglehart (1997). Using Inglehart's four-item post-materialism index, Uhlaner and Thurik (2004) document a negative correlation between total entrepreneurial activity and the level of post-materialism, i.e., higher average preference for greater 'voice' to people versus social order and economic stability. Hunt and Levie (2003), however, find that entrepreneurial activity exhibits weak and not always consistent correlations with cultural variables from Hofstede and Inglehart, and that these correlations pale in comparison with a strong positive link with population growth.

Thus, the literature is currently in a state of flux. The studies mentioned above are premised on the assumption of conceptual compatibility among social institutions that also underlies the institutional economics approach (North 1990; Williamson 2000). This premise, however, does not imply that only a unique cultural profile can support entrepreneurship, particularly when broad proxies like self-employment and business ownership serve to gauge it. Culture is the set of societal responses to general issues societies face. It is not impossible to assume that different cultures could achieve roughly equivalent levels of entrepreneurship, vaguely defined. Ulijn and Weggeman (2001) indeed argue to that effect with regard to Hofstede's model.

Yet there is a more disconcerting alternative to this 'cultural-relativism' hypothesis. In this view, the variable for entrepreneurship used by many studies—namely, self-employment and/or ownership of a small business—could be misleading. At the individual level of analysis, the more entrepreneurial individuals in any society indeed routinely start their own ventures on a small scale. However, at the societal level of analysis, some cultural environments may be more conducive to firm growth. Consequently, these societies will come to be populated by a distribution of enterprises that includes many large firms (cf. Desai et al. 2003). This is consistent with the fact that in developing countries—which tend to rank higher on collectivism, power distance, and (less systematically) uncertainty avoidance (Hofstede 2001)—the firm size distribution is heavily populated by very small firms (Tybout 2000; Cabral and Mata 2003).

Culture may exert its effect on levels and formats of entrepreneurial activity through numerous mediating channels. Above we considered the potential effect of culture on some personal traits relevant to entrepreneurship; below we will look at culture and widespread social norms or the law. The latter institutions are located either at the same level or at adjacent levels in Williamson's (2000) model. One is more likely to observe systematic relations with culture in these levels than between culture and higher-level phenomena, including specific facets of entrepreneurship, because mediating and/or additional (non-cultural) factors may obscure the link to the cultural environment – obscure, but not eradicate.

Beyond data availability limitations, the continuing use of Hofstede's data set, notwithstanding the fact that it originates in the late 1960s, reflects a broad consensus in the literature that culture is relatively stable. The main concern relates to the interaction between culture and economic development. Hofstede (2001) indeed argues that greater development increases individualism, and Inglehart's (1997) theory is predicated on economic progress. Nevertheless, the little evidence regarding historical trends in national culture suggests that absent severe external shocks cultural change is very slow (Schwartz, Bardi, and Bianchi 2000; Inglehart and Baker 2000). Among the factors contributing to this effect is the fact that cultural value priorities are imparted to individuals at very young ages (Goodnow 1997).

The entrepreneurship literature is largely consistent with this view, although little direct attention has been paid thus far to potential effects on entrepreneurship of such dynamic processes. McGrath et al. (1992) surveyed entrepreneurs from the United States, mainland China, and Taiwan with items related to Hofstede's dimensions. These researchers conclude that on the individualism/collectivism dimension, 'fifty years of exposure to very different ideologies have done little to break down the traditional collectivist Chinese culture' among the Chinese and the Taiwanese. McGrath et al. do find evidence suggesting value change on the power distance and uncertainty avoidance dimensions. Schmitt-Rodermund and Vondracek (2002) and Schmitt-Rodermund (forthcoming) present evidence on interrelations between parenting style, personality traits, entrepreneurial orientation, and entrepreneurial career prospects among German subjects. The results indirectly support the view that cultural values may induce path dependence in entrepreneurial activity (see also Woodruff 1999). This may have implications on transitional economies striving to encourage entrepreneurship (see Estrin, this volume).

GENERAL SOCIAL INSTITUTIONS

'The two most important "core" institutions for encouraging entrepreneurship are well-defined property rights and the rule of law,' aver Boettke and Coyne (2003: 77), echoing the current broad consensus that these social institutions are key for a thriving economy (Easterly and Levine 2002; Rodrik, Subramanian and Trebbi 2002; Acemoglu and Johnson 2003). Linking these institutions to entrepreneurship follows the same logic underlying institutional analyses of economic development: Widespread respect for well-defined legal entitlements and absence of arbitrary rent-seeking by power-holders (bribe-taking) reduce idiosyncratic risk and lower transaction costs. Being the prime agents of economic change, entrepreneurs are especially sensitive to these factors (cf. Baumol 1990; Harper 1998).1

We first consider entrepreneurship and informal institutions—specifically, the rule of law and corruption. It should be noted that some studies of institutions and development fail to distinguish conceptually or in their empirical specification between security of property rights, the rule of law, and corruption. Although such distinctions could be made, these informal institutions share conceptual elements as modes of wielding power, leading Licht, Goldschmidt and Schwartz (2003) to analyze them collectively as social norms of governance.

Examining the emergence of new firms in five formerly-soviet countries, Johnson, McMillan and Woodruff (1999, 2000, 2002) find that insecure property rights—defined as frequent need to make extralegal payments (bribes), protection, or inefficient courts—were more inhibiting to entrepreneurship than inadequate finance (see also Ovaska and Sobel 2003). Desai, Gompers and Lerner (2003), using a measure that intertwines both formal delineation and actual protection of property rights, find that in the emerging markets of Europe, greater fairness and greater property rights protection increase entry rates, reduce exit rates, and lower skewness in firm-size distributions. Laeven and Woodruff (2004) find that in Mexico, states with more effective legal systems have larger firms, suggesting that a rule-of-law state enables entrepreneurial firms to grow by reducing idiosyncratic risk. Cumming and colleagues use a measure of legality subsuming various indices of formal and informal legal protections and corruption to find that this measure predicts numerous beneficial features in venture capital transactions (Cumming, Schmidt and Walz 2004; Cumming and Fleming 2004). Perotti and Volpin (2004) recently advanced a political economy model and evidence that suggest that lack of political (democratic) accountability and economic inequality are hindrances to entry.

The literature is currently unsettled as to the antecedents of informal social institutions. The colonial heritage of countries clearly has affected these institutions, with a heritage of British rule generally predicting better outcomes (Acemoglu and Johnson 2003; Treisman 2000). Treisman (2000) also notes a correlation between Protestantism and lower corruption levels. Studies have documented systematic correlations between corruption levels and Hofstede's cultural dimensions (Husted 1999; Hofstede 2001; Tonoyan 2004). Drawing on Schwartz's (1999) cultural dimension theory, Licht, Goldschmidt and Schwartz (2003) find robust systematic correlations between national cultural profiles and perceived legality, corruption, and democratic accountability. Consistent with the preceding discussion, this evidence suggests that cultural orientations may impact entrepreneurship through their links with informal institutions.

Turning now to formal legal rules and their relations to entrepreneurship, we first note that every piece of legislation that affects business also bears on entrepreneurs. Beyond obvious issues like credit regulation and taxes, the list of relevant laws spans the gamut from regulation of entry (Djankov et al. 2002) to investor protection (La Porta et al. 1998) to procedural rules in commercial courts (Djankov et al. 2003). This literature generally holds that greater protection of economic interests ('property rights' broadly defined) and nimble courts lead to beneficial outcomes. Needless to say, the effectiveness of formal legal rules hinges on a widespread social norm of legality (Berkovitz, Pistor and Richard 2003), which, in turn, is strongly linked to national culture (Licht, Goldschmidt and Schwartz 2003).

Here we note one issue that has stirred considerable interest among entrepreneurship scholars, namely, the factors that facilitated the remarkable success of the high-tech industry in Silicon Valley. Saxenian (1994/1996) pointed out as such factor Silicon Valley's culture of openness, independence, democratic ('flat') corporate structure, and the Valley's 'pioneer' entrepreneurial spirit. Saxenian further contrasted Silicon Valley's

[1] Busenitz et al. (2000) define "country institutional profile" more capaciously than the conventional definitions in the economic literature, covering also what they call "cognitive dimension" and "normative dimension."

culture with Route 128's culture of secrecy, corporate hierarchy, and general Yankee conservatism. The Valley's 'high-velocity labor market' enabled skilled employees to switch firms frequently or start new firms as entrepreneurs (Hyde 1998). Gilson (1999) responds that the different regional cultures are the consequence—not the antecedent—of the two regions' legal rules concerning the enforceability of covenants not to compete. While Massachusetts enforces such covenants within limits on employees, the California courts interpret its employment law as flatly banning these covenants—according to Gilson (2003), due to an historical accident that cannot be duplicated elsewhere.

This case is noteworthy for several reasons. First, although Saxenian's analysis applied to the regional level one can identify in it the major features found in cross-cultural comparisons of countries that employ Hofstede's dimensions. Compared with Massachusetts, California is depicted as higher on individualism and lower on power distance and uncertainty avoidance – a 'frontier culture'. But as Hofstede (2001) relentlessly notes, such comparisons are always relative. The alleged rigidity of Route 128's culture relative to Silicon Valley's likely pales in comparison to non English-speaking cultures (see Schwartz 2004). Second, in the long run, formal legal rules and the surrounding culture should be conceptually compatible with one another (Williamson 2000; Licht, Goldschmidt and Schwartz 2004). While the legal precedents interpreting California's law as banning covenants not to compete preceded the emergence of Silicon Valley, these precedents have been adopted and not overruled since because they were compatible with their contemporary 'pioneer' culture. Finally, the Silicon Valley case indicates the limits of the clearer-and-better-protected-property-rights thesis. What is highlighted as the key to the Valley's success—be it legal or cultural—is a norm, that essentially eroded existing firms' intellectual property. California thus managed to achieve an optimal blend of a high-quality institutional environment with the right doze of Schumpeterian 'creative destruction' of property rights.

REPUTATIONAL BONDING AND SOCIAL CAPITAL

One of the main challenges for entrepreneurs around the world, but particularly for entrepreneurs in emerging and transition economies, is how to navigate around weak governance institutions at the country and regional level. Without strong governance institutions, especially without a strong legal system, outside investors go unprotected and are less likely to want to invest in a new entrepreneurial venture. The lack of strong governance institutions, therefore, stifles the broad sharing of technological and financial resources and capabilities across firm boundaries. Numerous studies, for example, have shown that firm-level development suffers from the lack of an effective rule of law (Demirgüc-Kunt and Maksimovic 1998; Levine 1999; Morck, Yeung, and Yu 2000; Wurgler 2000). Without sufficient rule of law, only some privileged networks of entrepreneurs will possess the enforcement mechanisms necessary to make joint investments, and the economy will see fewer large firms and more concentrated and entrenched ownership (He, Morck and Yeung 2003). Lower political accountability likewise hinders new entry (Perotti and Volpin 2004). Because both cultural and legal institutions are difficult to change (Milhaupt 1998; Roe 1996; Bebchuk and Roe 1999), firms in emerging economies select institutional strategies so that they can at least individually gain long-term access to outside resources and capabilities.

In all environments, entrepreneurs must build reputation-enhancing relationships with outside resource providers who are willing to share valuable information, technology and finance. At the earliest stages of a firm's existence, entrepreneurs require social contacts who can share the best leads on suppliers and customers. They also require financial investors willing to share scarce finance on an early-stage idea. Studies have shown that in emerging economies, credit constraints are one of the leading causes of small business failure (Fredland and Morris, 1976; Peterson and Shulman, 1987). Moreover, in most emerging economies, even just registering the firm and getting a business license is a long and cumbersome process (Djankov et al. 2002). Finding both talented and trustworthy employees is also difficult without help from reliable network contacts.

The challenge for the entrepreneur is how to gain the confidence of these network contacts so that they will trust the entrepreneur with their valuable time, technology, and finance. This trust is not easy to create. Transactions built on social capital are typically not written down on paper and are rarely enforceable in court. Instead, as Portes (1998) comments, these transactions based on social capital 'tend to be characterized by unspecified obligations, uncertain time horizons, and the possible violation of reciprocity expectations' (4).

In order to ameliorate the uncertainty and risk inherent in such transactions based on social capital, the entrepreneur can pursue what is termed a strategy of reputational bonding (Siegel 2004a). A reputational bonding strategy is an effort by the entrepreneurs to reduce their own incentive and maneuverability for later expropriating outside resource providers. The idea is to bond oneself by embedding oneself in a dense social network where the entrepreneur's future access to suppliers and customers is determined by an ongoing record of trustworthy business dealings. Much as in Greif's (1993) description of the Maghribi traders, entrepreneurs often seek out outside resource providers who share a common cultural bond. These cultural bonds are a major step towards building shared systems of fealty and honest business conduct.

But beyond drawing on shared historical relations, entrepreneurs must often go one step further in creating ongoing social systems of mutual investment and nonlegal enforcement. As told in Siegel (2004b), Korean entrepreneurs actively embed themselves in high school networks of elites. Just as for the Maghribi traders, Koreans share a collectivist culture based on shared identity and historical experience. While culture no doubt helps to facilitate resource sharing, culture is aided by ongoing firm-specific investments in network development and governance. These networks often take on the role of prosecutor, judge and jury in Korean society. Formal courts are costly and slow in operation. Members of the same network monitor each other and share information on each other's behavior with other members. When one member is alleged to cheat on one another, ongoing norms of community enforcement help to spread news of the transgression and to build legitimacy for a joint punishment. Only those who have most strongly embedded themselves in the network structure, and who have gone on to obey the social norms of conduct within the network, enjoy the largest benefits in terms of receiving large-scale investment from network members.

The concept of reputational bonding follows a long line of studies in the entrepreneurship literature on the 'network success' hypothesis. The seminal study in this tradition was that of Aldrich and Zimmer (1986), who noted that entrepreneurs are highly social actors who actively embed themselves in a social context. During the past decade, it has become an accepted theory in the global entrepreneurship literature that 'those entrepreneurs who can refer to a broad and diverse social network and who receive much support from their network are more successful (network success hypothesis)' (Brüderal and Preisendörfer 1998).

In order to understand how social capital helps entrepreneurs to gain the trust of outside resource providers, it is worthwhile to examine the mechanisms by which social capital leads to trust. Portes and Sensenbrenner (1993) compellingly describe the four sources of social capital. The first source, value introjection, is based on identity from birth with a group, and leads the individual to behave in altruistic ways specifically towards members of that group. The second source, reciprocity exchanges, leads individuals to act generously to others in a defined group based on an established norm of reciprocity. The third source of social capital, bounded solidarity, comes from having experienced a common event or set of events during the course of life with a defined group of people. For example, Marx believed that the fact of having been oppressed together in the same factory would lead members of the working class to feel class consciousness and to act collectively. The final source of social capital, enforceable trust, comes from an expectation that a defined group would punish any individual who treats another member of the group inappropriately. Of these four sources of social capital, the global entrepreneurship literature has placed emphasis on reciprocity transactions and enforceable trust, the two sources that are motivated primarily by rational utility maximization. The other two sources, value introjection and bounded solidarity, have been seriously understudied within the entrepreneurship literature. It is time that further attention be given to their theoretical importance since even the rational game-theoretical view of community enforcement often relies on an underlying cultural foundation based on common historical identity.

Prior studies measure the importance of social capital through a well-accepted set of measures. The main approach of the literature looks at the personal network of the entrepreneurs and explores the effects of the network size and depth on business performance. The following variables are all thought to be positive indicators of social capital: network size, network density, network diversity, the preponderance of strong or weak ties, and network redundancy (Brüderal and Preisendörfer 1998).

Strong ties are here defined based on the intensity of the relationship between two actors. Where intensity is high, the ties are labeled as being strong. This typically includes family members and close friends. Where intensity is low, but yet ongoing social contact is at least possible, the ties are characterized as weak. Granovetter (1974) found that network diversity through weak ties is most essential to gaining nonredundant information about the labor market. Burt (1982) further argued that entrepreneurs seeking information and market leverage should pursue bridging weak ties between otherwise disconnected economic actors.

While weak ties may be most useful for accessing information and leveraging, strong ties are believed most essential for building the trust necessary for joint investment and collaboration. Coleman (1990) argued using a rational choice logic that strong ties are most helpful to those economic actors who require a social community that can enforce norms and good behavior. Coleman's (1990) concept of closure is the most important in understanding the importance of strong ties for reputational bonding. Closure means the existence of a sufficient density of ties among a group of people to guarantee the faithful observance of norms. With a higher degree of mutual interaction, it becomes possible to have nonlegal/extralegal social enforcement of informal obligations. And with enforcement comes trust and increases in joint investment for entrepreneurial ventures. The rational choice explanation, however, is mostly not by itself sufficient to explain why dense ties lead to trust. Rational enforcement is potentially bolstered also through the process of value introjection and bounded solidarity cited above. With dense ties comes the potential for joint experiences within a densely connected group. The dense ties not only bring a greater probability of shared experience, but also allow for the cultural lessons and values drawn on those experiences to be more easily taught and positively reinforced within the shared community.

The conclusion of this literature is not that investment in one type of social ties is uniformly better than another, especially given the fact that these ties bring different types of resources to the entrepreneur. Strong ties can bring in resources that depend on nonlegal enforcement of obligations. These resources can include finance, technology and human capital. Weak ties, in contrast, can help the entrepreneur with accessing the diverse market information necessary to evaluate alternative managerial choices, to negotiate better terms with suppliers and customers, and to think of new solutions to business problems not already solved within the entrepreneur's existing network.

Prior studies measuring investments in both strong and weak ties had some serious flaws, and without empirical remedies, the literature is left without a clear idea of how these ties are created and what are their actual returns to the entrepreneurial venture. One set of studies focused on the opportunity structure by asking how many social contacts an entrepreneur might conceivably be able to approach for support (Aldrich and Zimmer 1986). This strategy did not go further to ask what investments entrepreneurs actually had made in trying to access this social structure. A second set of studies took the latter approach to trying to isolate the actual investment in social capital (Aldrich, Rosen, and Woodward, 1987; Aldrich, Reese, and Dubini, 1989), and it is not surprising that these latter studies produce the most convincing findings about positive returns to investment in social capital (Brüderal and Preisendörfer 1998).

The other main challenge for this literature is about achieving more careful econometric identification of social capital as distinct from unobserved firm quality and other parts of the error term. In fact, without clear identification, many studies have failed to find any positive benefits from social capital. Aldrich, Rosen, and Woodward (1987) could not find significant positive effects of six social capital measures on business profitability. Also, without more careful econometric identification, numerous studies have found evidence suggesting that the decision to invest in social capital is really just an artifact of having weak resource endowments and a high probability of failure based on market performance (Bates 1994; Waldinger, Aldrich, and Ward, 1990; Light and Bhachu, 1993). Without finding instruments that isolate the decision to invest in social capital, these studies leave many open questions about whether social capital is actually of first-order importance when compared to unobserved human capital quality and other resource endowments inside the firm. It could be the case the 'network success' hypothesis should be replaced with the 'network compensation' hypothesis, by which weak firms compensate their weakness with social support (Brüderal and Preisendörfer 1998). But we will not know a more definite answer to this debate unless future studies solve these challenges of identification.

The empirical solution is to adopt greater use of instruments and exogenous shift variables to better identify the returns to investments in social capital and reputational bonding. Most models in the global entrepreneurship literature have focused on cross-sectional samples in which firm quality is proxied by recent sales growth. As Davidsson and Honig (2003) point out, such cross-sectional analysis cannot be used to determine at what stages of the entrepreneurial process the investment in social capital is important. As Hoang and Antoncic (2003) appropriately argue, entrepreneurial studies should be longitudinal and show how network content, governance and structure emerge over time. This is true, but even when work is focused on a certain stage of an entrepreneurial venture, any analysis that uses observables like sale growth as the only effort to control for unobserved quality will not lead to clear identification. The problem is that even with an observable variable like sales growth, there is still a high potential for the unobserved portion of firm quality in the error term to be correlated with the coefficient on network investments.

There are solutions to this core methodological problem in the literature, and one example comes from a neighboring literature on overall social network effects. Bertrand, Luttmer, and Mullainathan (2000) wanted to test the theory in social science that poverty reinforces itself through social networks. The problem with demonstrating the economic importance of networks is that network effects may be highly correlated with unobserved individual, group and societal characteristics. In asking whether an individual was more likely to apply for social welfare if they lived next to other people on social welfare, Bertrand et al. devised a clever empirical design to deal with the unobserved factors. They focused on the fact that individuals who speak a non-English language at home tend to interact mainly with other who speak that language. Bertrand et al. could insert fixed effects both for the neighborhood and for the language groups present in the neighborhood. With the fixed effects, they could soak up the unobserved factors. By then focusing on the interaction between language group and welfare use, they could show clear identification of strong network effects on welfare use.

While this empirical strategy of finding an instrument (in this case non-English language groups interacted with welfare use) for network connections is highly useful, few studies in the global entrepreneurship literature have tried to come up with instruments. It is, nevertheless, possible to find instruments in various countries that can be used to cleanly identify the returns to entrepreneurial investment in social capital and reputation. One example is the study on investments in Korean social capital by Siegel (2004b). That study exploited two facts common to Korean society: (1) South Korean elites tend to favor members of the same high school network because high schools are the channel by which elites from politically hostile regions form personal alliances; and (2) South Korea has undergone a series of political shocks whose main effect has been to remove one high school network from political power and to replace it with another. By focusing on the choice of an entrepreneur to hire a CEO or other senior executive from one rival network or another, and then by measuring the returns to these connections through their interaction with multiple political shocks, Siegel (2004b) was able to cleanly identify the importance of social networks for Korean entrepreneurs in gaining access to outside resources.

The challenge for future empirical work in this literature is to look for instruments that determine investments in certain types of social capital, or else exogenous shocks that only affect entrepreneurs who have made certain investments. Without clear identification strategies, it is difficult to differentiate the 'network success' hypothesis from rival hypotheses focusing on the unobserved quality of individual entrepreneurs. The literature has made enormous strides in doing more careful longitudinal analysis, but more work on the process of entrepreneurship and the concurrent process of reputation building is needed.

CONCLUSION

This paper has given a broad overview of what are the social dimensions of entrepreneurship and how scholars have studied entrepreneurial attempt to build social advantage and reputation in the face of weak macro-level institutions for resource sharing. It is precisely in environments of weak resource-sharing institutions that reputation becomes both a scarce and economically more valuable asset. To build reputation, entrepreneurs must bond themselves by affiliating with a social network. Theory has predicted that entrepreneurs who invest the most in social capital will enjoy the highest overall financial returns. Yet empirical work testing this hypothesis has been inconclusive. Improved identification strategies are needed to better delineate the mechanism by which investments in social capital lead to sustainable competitive advantage.

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