CHAPTER 19

THE SOCIAL DIMENSIONS OF ENTREPRENEURSHIP

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19.1 Introduction

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.

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Research on social dimensions of entrepreneurship has made considerable progress since Shapero and Sokol (1982). While these scholars drew primarily on sociology and anthropology (focusing especially on studies of minority and immigrant communities), current research employs a variety of disciplinary approaches. The predominant analytical framework has been Hofstede's (1980, 2001) psychological theory and dataset on cultural value dimensions (Hayton et al., 2002). Recent years have witnessed an emergence of entrepreneurship research in mainstream economics, some of which relates to legal institutions. The current literature exhibits considerable methodological disarray, however. There is no agreed definition for entrepreneurship—for example, whether innovation is a necessary element or does self-employment suffice, or whether self-employment and ownership of a small business firm are equally entrepreneurial (see Ulijn and Brown, 2003). Likewise, there is often no clear definition of, and distinction among, various social institutions. This makes it difficult to compare and even relate studies to one another.

We adopt an institutional economics approach as the basic analytical framework for this chapter. Social institutions are thus defined as the written and unwritten 'rules of the game': laws, norms, beliefs, and so forth (North, 1990). This framework is enriched primarily with insights from cross-cultural psychology, the discipline that specializes in cross-national comparisons of culture. Where possible, we draw connections to other disciplines, although we are influenced by both expertise limitations and a space constraint to focus on the teachings of economics and social psychology. The reader is referred to other chapters in this volume that focus in great depth on these other perspectives.

Although this chapter is dedicated to social dimensions of entrepreneurship, we begin with a discussion of entrepreneurial motivations conducted at the individual level of analysis. Social institutions (especially culture and norms) affect the way individuals perceive the social role of the entrepreneur and how much individuals desire to become one. The documented richness of entrepreneurial motivations suggests that entrepreneurial behaviour responds to a rich set of cues from the social environment.

To organize the discussion of social institutions we draw on Williamson's (2000) framework for institutional analysis. This 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, statutes, property rights, and so on. Informal institutions exist in the shared subjective knowledge of societal members. Formal institutions are relatively more objectively verifiable through formal documents. Institutions at both Levels 1 and 2 usually apply generally to all societal members. Minority sub-groups may develop different informal institutions, however, and local authorities may promulgate locally-applicable regulations.[2] Level 3 deals with aligning governance structures with transactions. Such structures comprise contracts, firms, and also networks. Level 4 deals with marginal analysis of prices and resource allocation. This level is of less concern here because strictly speaking, it is not an institution.

The core assumption underlying this model is that in the long run, elements located in adjacent levels should be compatible with one another as should specific institutions within each level. Thus, laws adopted organically (as opposed to forced transplantation) at Level 2 would reflect general cultural orientations, shared assumptions and beliefs from Level 1. Parties to economic transactions would structure their interaction at Level 3 in light of the strengths and weaknesses of the institutional backdrop of Levels 1 and 2. Feedback channels may reinforce institutions at lower levels. Sections 3–5 below demonstrate how specific aspects of entrepreneurship relate to social institutions at various levels.

19.2 The entrepreneur: An individual portrait

Some 70 years ago, Schumpeter (1934: 93–4), the patron saint of all entrepreneurs, 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

[2] This chapter concentrates on country- or nation-level societies. Entrepreneurship among subcultures such as immigrants and minority groups is discussed in Basu (Ch. 21 of this Handbook).

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. First, entrepreneurs may not be motivated primarily by pecuniary incentives. 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. Moskowitz and Vissing-Jørgensen (2002) and F. Kerins et al. (2004) provide evidence that entrepreneurs forgo financial benefits in order to engage in entrepreneurship. 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, in their decision to start a new venture, wealth attainment was a significantly less important dimension relative to an aggregate of ten other decision dimensions (specifically: vision, stability, power, lifestyle, leadership, innovation, independence, ego, contribution and challenge).

The leading explanation for these results is based on non-pecuniary 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. In any event, 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.[3]

Secondly, among the non-pecuniary motivations that guide entrepreneurs, autonomy, or independence, stands out as a first-order consideration. Hamilton's (2000) evidence strongly suggests that self-employment offers substantial non-pecuniary benefits, such as 'being your own boss'. Several studies hold that entrepreneurs find special importance in their independence (Blanchflower and Oswald, 1998; Blanchflower, 2000; Blanchflower et al., 2001; Hundley, 2001). Frey and Benz (2003), using survey data from the United Kingdom, Germany, and Switzerland, argue that the greater independence and autonomy of self-employed persons is largely responsible for their particular job satisfaction. Frey and Benz (2003), in a sample of 23 countries that include non-Western countries, find that the

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

self-employed are substantially more satisfied with their work than employed persons. 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, 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. However, 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).

Thirdly, the special preference for autonomy found among entrepreneurs is not the only special characteristic that they exhibit in comparison to average population. Several studies maintain that entrepreneurs are more over-confident than regular people are and appear to be driven by wishful thinking (Bernardo and Welch, 2001; Arabsheibani et al., 2000; Cooper et al., 1988). Compared with non-entrepreneurs, entrepreneurs behave as if they understand the present fairly well but have rather special views regarding the future. A pilot survey comparing Russian entrepreneurs and non-entrepreneurs finds several characteristics distinguishing the former from the latter (Djankov et al., 2004). Specifically, that entrepreneurs move more frequently from one occupation to another—consistent with having a broader set of skills, greater confidence, and a greater tendency to explore new avenues.

The image of the entrepreneur reflected in these studies is still very fragmented. To gain a better understanding of these entrepreneurial motivations, we draw on insights from the psychology literature. While the literature on entrepreneurship and individual-level psychology is voluminous and lies beyond the present scope,[4] here we note briefly 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 et al., 1998).

Researchers have developed a multi-dimensional construct of entrepreneurial orientation with three sub-dimensions: innovation, proactiveness, and risk-taking,

[4] For a review see Rauch and Frese (2000). Wadeson (Ch. 4 in this Handbook) reviews the cognitive aspects of entrepreneurship concerning decision-making and attitudes to risk.

and established its validity in several national samples (Miller, 1983; Covin and Slevin, 1989, 1991; Lumpkin and Dess, 1996; Kreiser et al., 2001). These dimensions capture more elements of entrepreneurial motivations and behaviour 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 et al., 2001).

A notable feature of this branch of literature, however, is the paucity of studies on the role of personal values in differentiating entrepreneurs from salary earners. Values are conceptions of the desirable—a motivational construct. They represent broad goals that apply across contexts and time (Rokeach, 1973; Schwartz and Bilsky, 1987, 1990). Personal value emphases have been systematically related to individuals' behaviour (e.g. Bardi and Schwartz, 2003). Drawing on Rokeach's (1973) theory of values, Bird (1988) and Sarasvathy (2001) proposed that entrepreneurs' personal value emphases may distinguish them from other people (see also Djankov et al., 2004). 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 propose, 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.

19.3 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 et al. (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 et al. (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 as 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, 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 et al., 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 societal 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 about individual motivations and did not postulate a societal ethic. The two theories apply to different levels of analysis. An important inference from this distinction is that individuals with entrepreneurial characteristics will be found in every society, as part of the general distribution. Societies may differ, however, in the institutions that could affect the relative portion of the entrepreneurial sub-group and which facilitate or hinder entrepreneurial activity. Hence, Schumpeter (1934) cannot be considered 'a refutation of Weber's theory' (cf. Brouwer, 2002: 85).

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. Virtually without exception, researchers used Hofstede's original four cultural value dimensions of individualism/collectivism, power distance, uncertainty avoidance, and masculinity/femininity.[5] Thus, Meuller and Thomas (2001) 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).

According to Hofstede, low uncertainty avoidance 'implies a greater willingness to enter into unknown ventures' (2001: 164). Hayton et al. (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 the level of entrepreneurship in countries, Shane (1993) argues for the realized validity of most of the hypothesized correlations. Morris et al. (1993), however, argue for a curvilinear relation between individualism/collectivism and corporate entrepreneurship. Other 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, 2003).[6]

These studies and earlier ones in a similar spirit (e.g. Shane (1994, 1995)) have associated entrepreneurship with a particular cultural profile—in particular, high individualism and low uncertainty avoidance. At present, we do not believe it is possible to reach such a conclusion, given the lack of agreement on what constitutes a valid dependent variable (number of registered entrepreneurial ventures, patent filings, or something else) as well as a need for more precise econometric identification in the entrepreneurship literature. As a broad generalization,

[5] 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 levelled against it. A later addition to Hofstede's (1980) theory is a cultural dimension derived from Chinese Culture Connection (1987) that was dubbed Confucian dynamism or long-term orientation. See Hofstede (2001); see also Schwartz (2004).

[6] See also Uhlaner and Thurik (2004) and Hunt and Levie (2003) for discussions using Inglehart's (1997) materialism/post-materialism value dimension.

researchers have also tended to use individual-level constructs and instruments that were developed in the United States (Kreiser et al., 2001). More work is needed to establish these elements' universality, as has been done more recently 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 and of other combinations of cultural orientations (profiles). Entrepreneurship à la Schumpeter and Kirzner involves motivation, cognition, and action, with possible mediators like intention (Krueger, Reilly and Carsrud 2000). The entrepreneur acts on what he or she perceives as a valuable opportunity, driven by his or 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.[7] A growing literature now proposes that the Western notion of individual agency may not similarly apply in other cultures. Recent authors in social psychology have argued that cultures known to value embeddedness over autonomy are also more highly populated by individuals with a greater distaste on average for autonomous action (Menon et al., 1999; Markus and Kitayama, 2003; J. G. Miller, 2003).

Importantly, however, variations in cultural beliefs regarding individual autonomy do not by necessity preclude nor diminish entrepreneurship in non-Western societies. At the societal level, stronger collectivist orientations may not be detrimental to entrepreneurship if cultural emphases in the society on other dimensions support entrepreneurial action. Particularly relevant in this regard are cultural values that emphasize change or certain time-preferences. It therefore may be possible for Chinese and other entrepreneurs coming from Confucian-influenced societies to succeed in a highly collectivist environment while drawing legitimacy for their conduct from a cultural emphasis on active change.

Thus, the literature is currently in a state of flux. Causal explanations relying on cultural differences remain provocative at present and more work is needed to verify their robustness (see Morse et al., 1999; Mitchell et al., 2000; Begley and Tan, 2001). 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

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

equivalent levels of entrepreneurship, vaguely defined. Ulijn and Weggeman (2001) indeed argue to that effect with regard to Hofstede's model.

Yet there is still 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). These findings may still underestimate the scope of the problem when one recalls that entrepreneurship in the unofficial economy is often unaccounted for and is likely to be concentrated in low-size firms.

Culture may exert its effect on levels and formats of entrepreneurial activity through numerous mediating channels. We have already considered the potential effect of culture on some personal traits relevant to entrepreneurship; now 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 dataset, 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 on post-materialistic values 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 et al., 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, consistent with Goodnow (1997). These results are consistent with the view that cultural values may induce path dependence in entrepreneurial activity (see also Woodruff, 1999). More indirectly, Della-Giusta and King (Ch. 24 in this Handbook) describe what they consider a failed attempt to establish an 'enterprise culture' in the United Kingdom by the Thatcher government. This may have implications for how transitional economies can better encourage entrepreneurship (see Estrin, Meyer, and Bytchkova, Ch. 27 in this Handbook).

19.4 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 (Rodrik, Subramanian and Trebbi, 2002; Acemoglu and Johnson, 2003; Easterly and Levine, 2003). The linking of these institutions to entrepreneurship follows the same logic underlying institutional analyses of economic development: that is to say, 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. Entrepreneurs, being the prime agents of economic change, are especially sensitive to these factors (cf. Baumol, 1990; Harper, 1998).[8]

The institutions discussed in this section apply to the general society—usually, a nation. These institutions are more issue-specific than cultural orientations but are still generally applicable in comparison to norms and rules prevailing in subgroups such as local communities, corporate employees, or industry professionals. We first consider entrepreneurship and informal institutions—specifically, the rule

[8] 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'.

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, the fact that these informal institutions share conceptual elements as modes of wielding power, leads Licht, Goldschmidt and Schwartz (2004) to analyze them collectively as social norms of governance.

On 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 extra-legal payments (bribes), protection, or inefficient courts—were more inhibiting to entrepreneurship than inadequate finance. 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. Further discussion and comprehensive background on institutions and entrepreneurship in transition economies is provided in Chapter 27 in this Handbook (see also Ovaska and Sobel, 2003).

Theory and evidence are not limited to transition economies, however. 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, 2003). Perotti and Volpin (2004) recently advanced a political economy model in which evidence suggests that lack of political (democratic) accountability and economic inequality hinder entry.

The literature is currently unsettled as to the antecedents of informal social institutions. Some authors have noted a correlation between the mode of colonialization and the quality of governance institutions (Acemoglu and Johnson, 2003; Treisman, 2000). On the other hand, underlying cultural beliefs seem to be even more highly correlated with the quality of governance (Treisman, 2000; Husted, 1999; Hofstede, 2001; Tonoyan, 2004). Drawing on Schwartz's (1999) cultural dimension theory, Licht, Goldschmidt and Schwartz (2004) argue for robust correlations between cultural orientations and perceived legality, corruption, and democratic accountability. Consistent with the preceding discussion, this evidence suggests that cultural orientation may impact entrepreneurship through their links with informal governance institutions. More work is needed to identify the precise mechanisms by which culture and formal laws interact in influencing the quality of governance in a society.

We turn now to formal legal rules and their relations to entrepreneurship, and in the first place note that every piece of legislation that affects business also bears on entrepreneurs. Entrepreneurs, it turns out, complain first about taxes when asked about obstacles to entrepreneurship (Estrin et al., Ch. 27 in this Handbook). Beyond obvious issues like credit regulation and taxes, the list of relevant laws spans the gamut from regulation of entry, measured by the steps required to establish a firm (Djankov et al., 2002), to investors' legal rights (La Porta et al., 1998) to procedural rules in commercial courts (Djankov et al., 2003). Thus, Klapper, Laeven and Rajan (2004) document a correlation between more intensive entry regulation and lower firm growth as well as lower entry in less corrupt countries. 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, 2004).

Note in this respect that many countries have a substantial unofficial sector (black market). Well-known measurement problems with regard to this sector also make it difficult to assess institutional antecedents of entrepreneurship in these economies. Johnson et al. (2000) find that in five post-communist countries, the size of hidden 'unofficial' activity (of 'official' firms) rises with effective tax rates, corruption, greater incidence of mafia protection, and less faith in the court system. Klapper et al.'s (2004) finding that regulatory entry barriers have no adverse effect on entry in corrupt countries, should thus be interpreted with the understanding that entry into the official economy is already strongly deterred by systemic institutional weaknesses noted above.

Here we highlight 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 (1996) pointed out Silicon Valley's culture of openness, independence, democratic ('flat') corporate structure, and the Valley's 'pioneer' entrepreneurial spirit as such factors. Saxenian further contrasted Silicon Valley's culture with Route 128's culture of secrecy, corporate hierarchy, and general Yankee conservatism. The Valley's 'high-velocity labour 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

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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 that of Silicon Valley very likely pales in comparison to other institutional environments (see Schwartz, 2004). Secondly, in the long run, formal legal rules and the surrounding culture should be conceptually compatible with one another (Williamson, 2000; Licht et al., 2005). 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 dose of Schumpeterian 'creative destruction' of property rights. Whether countries can mimic California's precedent is debatable on positive and normative grounds.

19.5 Networks, reputational bonding and social capital

Networks are an organizational form distinct from both market exchange and firms (Granovetter, 1973). In the entrepreneurship context, networks may serve a variety of social purposes for facilitating entrepreneurship. McCann (Ch. 25 in this Handbook) reviews the role of networks in facilitating clusters, industrial districts and regional development. Several recent studies point to social networks as information dissemination mechanisms that facilitate entrepreneurship (Saxenian, 2002; Djankov et al., 2004; Guiso and Schivardi, 2005; Gompers et al., 2005). Here, we focus on social networks as a structural response to the social environment of governance institutions—namely, to the formal and informal institutions at deeper levels. Responding efficiently to the institutional environment is essential, and more difficult, where governance institutions are weak. However, social networks also prove valuable where these institutions are generally stronger but cannot address problems that entrepreneurs face in certain industries or at early stages of projects.

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 et al., 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 et al., 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 licence 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 (1998:4) comments, these transactions based on social capital 'tend to be characterized by unspecified obligations, uncertain time horizons, and the possible violation of reciprocity expectations'.

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, 2005). A reputational bonding strategy is an effort by the entrepreneurs to reduce their own incentive and manoeuverability for later expropriation of 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.

Beyond drawing on shared historical relations, entrepreneurs must often go one step further in creating ongoing social systems of mutual investment and non-legal enforcement. As told in Siegel (2006), 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 behaviour 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).

Reputational bonding is not just a successful strategy for firms in countries with weak legal institutions: it is also an essential strategy for firms in advanced knowledge-driven industries around the world where the rules of competition are in play, the value of an inventor's new technology is uncertain to outside investors and cannot easily be described and paid for through an *ex ante* contract, the important sources of knowledge are disperse and held by a large number of decentralized actors, and where the inventors must rely heavily on outside investors and collaborators for key complementary resources and skills. As illustrated in Powell (1996), biotechnology companies in the US were often started by scientists without managerial experience, access to finance, or access to product distribution channels. As a result, these biotech entrepreneurs used outside collaborators to share in the task of management, marketing, and the attraction of financial resources.

In any knowledge-driven industry, because so many projects cannot be directly contracted on *ex ante*, an entrepreneur's reputation is key to gaining access to outside complementary resources through networks of potential collaborators. In more recent work, Powell et al. (2005) show that the biotechnology industry is characterized by frequent changes in the entrepreneur's need for specific outside complements, and by a kind of dynamism where an external collaborator's knowledge is essential today, not needed tomorrow, but then might become essential at some point in the future. It is precisely in this kind of environment of uncertainty that a firm must learn how to enter and exit partnerships while maintaining a near-pristine reputation for fair dealing.

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. 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 labelled 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 non-redundant information about the labour 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 behaviour. 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 non-legal/extra-legal social enforcement of informal obligations. 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 on p. 527. 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 non-legal 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 their actual returns to the entrepreneurial venture are. 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 et al., 1987; Aldrich et al., 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 et al. (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 et al., 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, no analysis that uses observables like sale growth as the only effort to control for unobserved quality will 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 neighbouring literature on overall social network effects. Bertrand et al. (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 others who speak that language. Bertrand et al. could insert fixed effects both for the neighbourhood 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 (2006). That study exploited two facts common to Korean society: (1) South Korean elites tend to favour 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 the main effect of which 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 (2006) was able to 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.

19.6 Conclusion

This chapter has given a broad overview of what the social dimensions of entrepreneurship are, and how scholars have studied entrepreneurial attempts 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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