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Institutions and Entrepreneurship

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Editors

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RESEARCH IN THE SOCIOLOGY OF WORK VOLUME 21

INSTITUTIONS AND ENTREPRENEURSHIP

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INVESTOR IN PEOPLE

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INSTITUTIONS AND ENTREPRENEURSHIP

Wesley D. Sine and Robert J. David

INTRODUCTION

How do institutions affect entrepreneurship? Conversely, how do entrepreneurs impact institutions? Institutional theory has long struggled to explain the action and agency inherent in entrepreneurship (DiMaggio, 1988; Barley & Tolbert, 1997). Contemporary institutionalist research in organization studies began with the question of how the institutional environment shapes the structures and behaviors of existing organizations. This research largely focused on how normative, regulative, and cognitive dimensions of the environment (Scott, 2008) constrain large, mature organizations and the circumstances that increase the adoption of new structures by such organizations (Meyer & Rowan, 1977; DiMaggio & Powell, 1983; Tolbert & Zucker, 1983). A subsequent wave of research in the institutional tradition focused on institutional change within mature organizational fields (see Dacin, Goodstein, & Scott, 2002). Some recent research has studied the actors – "institutional entrepreneurs" – that create new or transform existing institutions (e.g., Greenwood, Suddaby, & Hinings, 2002; Maguire, Hardy, & Lawrence, 2004). Much less attention, however, has been paid within the institutional-theory literature to *entrepreneurship*: the processes of founding and managing new organizations.

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While institutional theory has often ignored entrepreneurship, past research on entrepreneurship has often focused on the individual at the expense of understanding the important role that the broader context plays in shaping who decides to found an organization, the types of organizations that are founded, and their structures (Eckhardt & Shane, 2003; Aldrich & Ruef, 2006). Much of the traditional entrepreneurship literature focused on the personal characteristics of entrepreneurs, but largely overlooked the role of the environment. More recent work has taken into account how the availability of resources affects entrepreneurs. This work has conceptualized the environment as a set of technologies, resources, and shortages that entrepreneurs discover and exploit (Kirzner, 1973, 1997). However, this literature generally takes for granted the existence of entrepreneurs and opportunities and fails to account for the institutions that delineate appropriate resources, means, and categories of actors for engaging in entrepreneurship. Moreover, past research in entrepreneurship has typically overlooked the collective actors that facilitate new organizational foundings, such as industry associations, social movement organizations (SMOs), and certification organizations (Swaminathan & Wade, 2001). In essence most prior work on entrepreneurship has paid little attention to the social construction of entrepreneurship: how social norms, values, taken-for-granted beliefs, and explicit and implicit regulatory exigencies shape opportunities and affect whether or not individuals choose to engage in entrepreneurial activity.

As a result of this mutual neglect, the points of connection between the insights of institutional theory and the empirical phenomenon of entrepreneurship have often remained implicit rather than explicit. Recently, however, a number of scholars have begun to systematically explore the relationship between institutional theory and entrepreneurial activities (e.g., Hwang & Powell, 2005; Tolbert, David, & Sine, 2011). This edited volume is an attempt to further this growing stream of work. We believe that institutional theory provides the conceptual apparatus to understand the social construction of entrepreneurship: how entrepreneurs come to be entrepreneurs, how entrepreneurial opportunities are created, how such opportunities are evaluated and exploited, and how institutional environments are manipulated to support entrepreneurship. In our view, an institutional approach to entrepreneurship shifts attention away from the personal traits and backgrounds of individual entrepreneurs and toward how institutions shape entrepreneurial opportunities and actions; how entrepreneurs navigate their cognitive, normative, and regulatory environments; and how actors modify and build institutions to support new types of organizations.

In addressing such questions, this volume takes a distinctively sociological approach to entrepreneurship. The institutional perspective on organizations from sociology "emphasizes the ways in which action is structured and order made possible by shared systems of rules that both constrain the inclination and capacity of actors to optimize as well as privilege some groups whose interests are secured by prevailing rewards and sanctions" (DiMaggio & Powell, 1991, p. 11). Early institutional research in organizational sociology often presented dichotomies of rational action versus institutionalized behavior and of technical versus institutional environments (Scott & Meyer, 1983; Scott, 1987). Later research focused on how institutions constitute the menus from which choices are made (DiMaggio & Powell, 1991). Rather than "rational versus institutional," the emphasis shifted instead to the social construction of choice and behavior (David & Bitektine, 2009). In other words, the institutional perspective on organizations emphasizes how socially constructed environments shape organizational behaviors and outcomes. W. Richard Scott, a pioneer in this work, conceptualized the institutional environment as having regulative, normative, and cultural–cognitive pillars or dimensions (Scott, 2008). These three pillars elicit three related, but distinguishable bases of organizational legitimacy: regulatory, which emphasizes adherence to rules; normative, which stresses a moral basis for legitimacy; and cultural–cognitive, which points to the legitimacy that comes from conforming to taken-for-granted understandings, roles, or templates (Scott, 2008, p. 61; see also Suchman, 1995).

An institutional perspective on entrepreneurship then is one that examines how the regulative, normative, and cultural–cognitive dimensions of the environment shape entrepreneurial processes, such as identifying, creating, and exploiting opportunities, firm founding, initial growth, and exit. This translates to questions such as: Which institutional actors shape entrepreneurial activity and how can entrepreneurs access them? What organizational structures are taken for granted as necessary for obtaining certain types of resources and how do such structures become taken for granted? What drives changes in the norms that govern acceptable levels of risk versus reward across different eras (e.g., Laseter, Kirsch, & Goldfarb, 2007)? Institutions indeed constitute many of the barriers and opportunities faced by entrepreneurs, and while early institutional research emphasized conformity to existing institutional requirements as a prerequisite to acquiring organizational resources, recent work has paid greater attention to the role of entrepreneurs in both manipulating and modifying the institutional environment (e.g., Sine, David, & Mitsuhashi, 2007; Zott & Huy, 2007).

Below we describe in more detail how the dimensions of the institutional environment relate to entrepreneurship.

INSTITUTIONAL ENVIRONMENTS AND ENTREPRENEURSHIP

Cultural–Cognitive Dimension

This dimension of the institutional environment describes those ideologies, logics, or cognitive frames that are widely diffused and deeply embedded in a social setting. It captures the taken-for-granted assumptions about particular processes and organizational forms (Berger & Luckmann, 1966; Meyer & Rowan, 1977; Aldrich & Fiol, 1994). It includes general assumptions about how things are done. For example, the importance of business plans, their content, length, and organization, is taken for granted by many high-technology entrepreneurs and important constituents such as venture capitalists, potential employees, customers, and partners. Entrepreneurs trying to get support, financial or otherwise, for a potential new business will have limited success without a business plan despite the market potential of their venture. Moreover, this business plan needs to be congruent with widely accepted notions about what such a plan should look like. A business plan without critical elements such as several years of financial *proformas* and a break-even analysis would not even be considered by investors because it is assumed that a high-quality business plan includes these elements. Not including such analyses or including analyses that shows the business breaking even too soon (not sufficiently growth oriented) or too late (too risky) signals that the entrepreneur is not adequately knowledgeable or experienced. This is despite the fact that there is no evidence that such exercises are correlated with lower failure rates or that links particular levels of risk in a business plan to success.

The cultural–cognitive dimension is subtle and powerful (Suchman, 1995, p. 581) and underlies many of the challenges and opportunities facing entrepreneurs. It affects customer habits and what they see as valuable or value-less. For example, before 1970 in the United States, windy land was not viewed by most as a valuable commodity. Until the idea that wind-generated electricity had particular types of value associated with its means of production that a typical coal or oil generator did not (no emissions, clean energy), wind power was seen merely as a more expensive way to generate electricity. Once the beliefs of constituents about the pollution associated with coal and oil generators changed, windy land began to be viewed and treated as a valuable commodity (Sine & Lee, 2009).

Cultural–cognitive institutions also affect investors' evaluation of risk. Ventures that are new or incongruent with existing taken-for-granted models are often treated as being more risky. For example, in the 1970s and early 1980s despite its higher cost and potential for physical danger, nuclear power was seen by investors and legislators as a more attractive alternative power source than solar or wind. This occurred largely because the general production and business model of nuclear power was very similar to that of fossil fuel: they both used large centralized plants, both generated power using a commodity that could be mined and stored (as opposed to sunlight and wind), and both required large upfront expenses and could take advantage of similar tax structures. Also, nuclear power was largely initially advocated by the existing military–industrial complex. Businessmen representing large organizations with reputations were the key spokesmen. On the other hand, solar and wind were initially quite decentralized, more difficult to control, and advocated early on by hippies and environmentalists; these forms of energy thus received less attention from large investors (Hirsh, 1999).

Cultural–cognitive institutions thus shape the processes, structures, and information investors and consumers expect to see in a new venture. This creates great challenges for new ventures that are trying to promote new product categories or that are using new types of business models. By definition these ventures are considered, to some extent, not quite legitimate. Cultural–cognitive legitimacy in this sense is the extent to which a process or organization meets the taken-for-granted assumptions of a given constituency. Past theoretical work suggests that ventures face tremendous obstacles in assembling the resources necessary to commence operations; a lack of legitimacy makes a venture appear more risky and thus may impede its ability to attract top talent (at the price a new venture can afford), corporate partners, and investors. The legitimacy deficit of such ventures reduces their ability to acquire and organize the resources necessary to found a firm, and to produce and distribute a product or service (Hargadon & Douglas, 2001). Even firms that do manage to commence operations may still face great difficulty surviving because of their limited ability to attract resources (Aldrich & Ruef, 2006). The difficulty in founding a venture under such circumstances at times can be almost insurmountable, leading Aldrich and Fiol (1994) to describe such entrepreneurs as fools.

In sum, a measure of cultural–cognitive legitimacy is essential for entrepreneurs. Recent research has attempted to measure this dimension of legitimacy by investigating public discourse (Pollock & Rindova, 2003; Mezias, Lant, Mezias, & Miller, 2010). Another promising approach is to measure the cultural–cognitive legitimacy of an organizational form using *attempts* to found organizations. Because the founding process can take a great deal of time (in some cases 5 or more years) and many entrepreneurs attempting to found a venture are not successful, using only successful foundings (rather than attempts to found) as a measure of cultural–cognitive legitimacy results in temporal inaccuracy and underrepresentation (Sine, David, & Mitsuhashi, 2007). Moreover, to the extent that regional variables shape the relative success of founding attempts, successful foundings may be a more accurate measure of the ease of doing business regionally rather than of cultural–cognitive legitimacy.

Normative Dimension

This aspect of the institutional environment refers to the norms and values in a society and those actors that construct and enforce these norms and values. Norms and values include social definitions of what is "good" or "appropriate" and influence both the prevalence and evaluation of entrepreneurial processes and organizational forms. For example, some entrepreneurs may refuse to start a company that sells tobacco or pornography, or investors may discount power plants using "dirty" coal-fired technology (Sorkin, 2007) even if there is ample demand. At the same time, these investors may pay a premium for ventures that they perceive as increasing the social good such as power generators using "green" technology. To the extent that entrepreneurs' efforts are normatively legitimate, they will meet with less resistance and find more support for their efforts. Thus, the relative success of and resistance to entrepreneurs' efforts will be to some degree a function of the extent to which these efforts accord with widely held norms and values.

The normative dimension of the institutional environment also influences who will (and will not) become an entrepreneur. For example, career paths are a very important normative force that directly and indirectly influence entrepreneurial activity. Career paths (relatively stable, identifiable sequences of individuals' work experiences over time) affect the demographic distribution of individuals within sectors of activity (Lawrence & Tolbert, 2007) and the kinds of occupations that are considered prestigious and attractive. In some career paths, entrepreneurship is seen as a normatively positive activity and in others it is not. Career paths can also exclude individuals and groups from certain activities, for example, if their background does not match the expected trajectory. For instance, investors often look for particular types of experience in the founders of the organizations they support. Similarly, important resource suppliers to entrepreneurs such as venture capital firms have somewhat rigid expectations surrounding the career paths of potential hires. Thus, career paths can influence the makeup of organizations that play a key role in supporting new ventures. By shaping aspirations, training, experience, and possibilities, career paths to some degree shape the number of people who try to found firms, their legitimacy or illegitimacy as entrepreneurs, as well as the growth and survival rates of their ventures.

The normative dimension captures not only deeply held values and norms, but also those actors responsible for creating and enforcing such norms. Normative actors are of primary importance in facilitating and guiding entrepreneurial processes and shaping entrepreneurial outcomes, and this topic has begun to receive attention. For example, Buhr and Owen-Smith (2010) show how venture capital and law firms affect both the quantity and variety of entrepreneurs in a region. Scott (2010) elaborates on the core role that professions play in creating and maintaining the institutional contexts in which entrepreneurs operate. Below we list some of the key normative actors that can affect entrepreneurial processes and outcomes.

Industry and Professional Associations

Collective actors that are major sources of normative institutions, such as professional and trade associations, can have a large impact on both the founding and survival rates of entrepreneurial ventures. These organizations affect new ventures in several ways. First, through their rules of membership and informal sharing of information and prescriptions, they can shape how organizational structures and procedures are constructed and perceived by constituents. By selecting particular conference speakers, emphasizing certain topics in association publications, and disseminating information in other ways, such organizations often, intentionally or unintentionally, promote particular practices and forms of organization as "best," thereby creating form-specific normative support (Greenwood et al., 2002). Second, these collective bodies can provide a sense of legitimacy for new organizational forms because they are exterior to any one organization; they legitimate the organizational population and codify what it means to be a member of that population (David, Sine, & Haveman, 2010b). Third, they serve as a source of public information by spreading knowledge about the form (DiMaggio, 1991; Hiatt, 2010). Finally, professional associations are often directly involved in securing regulative support (or tolerance) of a particular organizational form (Hiatt, 2010). Empirically, Sine, Haveman, and Tolbert (2005) found that while the presence of an industry association in a state increased entrepreneurial foundings, it also narrowed the type of new ventures founded: once state industry associations emerged, foundings of more common organizations increased more rapidly than foundings of less common, riskier ventures.

Certification/Standards-Based Organizations

Certification organizations are also very important normative actors, and the past two decades have seen an increase in the number and importance of these organizations (Cashore, Auld, & Newsom, 2004; Bartley, 2007; Graffin & Ward, 2010). Similar to industrial and professional associations, these organizations codify and enforce standards and can thereby shape the structure of organizations. Certification organizations play especially important roles in new sectors. They can help diffuse knowledge about a new organizational form and help create consumer confidence in new types of product and service offerings. For example, certification organizations for organic food confirm the appropriateness of the category of "organic" to potential consumers (Lee, 2009). Certification organizations also evaluate the fit between organizations and particular categories such as green, socially responsible, etc. (Sine et al., 2007). These organizations play an essential role in instantiating the reality of a new form and demarcating its boundaries. Moreover, these types of organizations help maintain the legitimacy of a new form by removing imposters from the category and protecting the category from encroaching forms. Without such organizations, multiple competing claims about what a particular form is reduce the credibility of the form and its taken-for-grantedness. For example, the term "organic food" initially meant a multitude of things to a variety of people. Most people didn't seek out organic food because there was very little consensus about what it was and why it was normatively positive. The emergence of organic certification organizations helped clarify what the term organic meant, which organizations belonged (and didn't belong) in this category, and the benefits associated with the category. This led the way to market acceptance, as both retailers and consumers learned about the category and the value created by such organizations. Research by Lee, Sine, and Tolbert (2010) find that as membership in certification organizations increased, the founding rate of organic producers decreased, as did failure rates. Organic certification organizations, by defining and enforcing what it meant to be organic, increased the barriers to entry in this emergent