Examining Entrepreneurs' Responses to Regulatory and Normative Environments in Developing Countries

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Abstract

The paper examines entrepreneurs' responses to regulatory and normative environments in developing countries. We can better understand the role of these institutions in entrepreneurial activity particularly in a developing country context. From a practical perspective, the government can better target their efforts in building strong institutions to foster local entrepreneurial activity. Management practitioners can better understand management practices in developing countries.

Introduction

Hoskisson, Eden, Lau, Wright (2000) described two groups of emerging economies: transitional economies and developing countries. According to their descriptions, transitional economies are the former Soviet Union and China. Developing countries are countries in Asia, Latin America, Africa, and the Middle East. Transitional economies are in states of institutional and economic fluxes as ongoing privatization of public enterprises introduces new laws, upends existing norms, and challenges cultural understandings. Transitional economies undergo reforms that decrease governments' influences on business. As the countries implement new policies to reduce government's dominant influence on business activities, the established institutions evolve and there is the formation and consolidation of new habits and patterns.

On the other hand, many developing countries still have dominant government influences, shaky regulatory, pervasive normative and influential cultural-cognitive frameworks characterizing the institutional environment and significantly influencing business transactions (Pearce, Dibble, & Klein, 2009). A number of developing countries are low-income countries that are still struggling to attain the Western-kind of economic success of high GDP and high standards of living (Hoskisson et al., 2000). The bureaucratic structures here are notably inefficient. Many developing countries have unstable political systems that introduce a climate of uncertainty into the business environment. The developing countries' attempt at privatization and deregulation is at best poor and usually ill-suited to their current economic and political conditions. The institutional environment influences economic systems by defining the frameworks in which transactions are conducted.

The purpose of this article is to examine entrepreneurial responses to institutional environments in developing countries as there is limited research on how entrepreneurs handle complex and inefficient institutional systems in these countries. The difference between developing countries and transitional economies is that many developing countries do not have institutions in transition which may cause voids in institutional expectations. However, the myriad of competing forces in these environments still make entrepreneurs work in particularly challenging situations. This paper aims to examine the challenges of entrepreneurs and how entrepreneurs survive and thrive in these kinds of situations.

We can better understand the specific role of each of the institutional aspects, cognitive-cultural, regulatory, and normative, on entrepreneurial activity particularly in a developing country context. We gain deeper insights into how unclear government policies affect strategic planning and entrepreneur's responses to a complex, bloated bureaucratic system in developing countries. From a practical perspective, local entrepreneurs can gain further insights into the implications of their country's institutions on their strategic activities.

Theoretical Development

Most research on emerging economies focuses on multinational corporations (MNCs) and their entry strategies and strategic responses (cf. Luo, 2002). Researchers have studied the impact of corruption on entry strategies (Rodriguez, Uhlenbruck, & Eden, 2005), the implications of environmental and organizational factors on MNC strategies (Luo, 2002), analyzed the role of strategic partners and alliances in the international context (Pisano, Ireland, Hitt, & Webb, 2007), expanded on institutional distance (Xu & Shenkar, 2002), and the contextual impact on the evolution of entrepreneurial firms (Ahlstrom & Bruton, 2010). Most management studies explore strategies for the MNC. Scholars acknowledged that the dynamism, uncertainty, and the relatively unstructured form of the institutional frameworks shape MNC strategies in emerging economies (Rufin, Parada, & Serrra, 2008). Other research looked at the role of the government in inviting foreign investment into a country and institutional perspectives on transitional economies (Ahlstrom & Bruton, 2010). There is however, limited research on the local entrepreneur's strategic responses in the developing country. Specifically, small businesses and new ventures in developing countries make up about 95 percent of the workforce (Casillas, Acedo, & Moreno, 2007). Moreover, the institutional environment affects entrepreneurial activity differently in each economic climate (Peng & Heath, 1996).

Entrepreneurship is in of itself a risky venture. Emerging economies are generally described as complex, partly because of their unstable political situations, evolving economic conditions, and the influential normative prescriptions (Luo, 2002; Peng & Heath, 1996). Engaging in a risky venture in a dynamic context results in habits particularly attuned to that region. For example, Sonobe, Akoten, and Otsuka (2009) observed that many small and informal businesses in Africa have slow growth and yet these are the kind of businesses that dominate the manufacturing sector in sub-Saharan Africa.

This paper describes the influences of the institutional environment on entrepreneurial actions in an uncertain, resource-scared environment as the developing country. It explores the

strategic responses entrepreneurs adopt using the institutional view perspective. A number of studies on emerging economies attempt to explain government influence on business by using institutional theory as this theory encompasses the social, political and economic aspects of the environment (Peng & Heath, 1996). Often, entrepreneurs respond to more powerful government agents, influential normative prescriptions, and ingrained cognitive-cultural methods. Furthermore, entrepreneurs tend to develop short-term strategic plans to cope with uncertain surrounding regulatory framework. The paper further explores how entrepreneurs in developing countries achieve and maintain venture success.

The institutional framework is extremely crucial in the race for scarce resources. To that end, the local entrepreneur seeks to understand and abide by authority prescriptions and socially contrived expectations to accrue consequential benefits for his or her venture and to avoid undue harassment by government agents (Fadahunsi & Rosa, 2002). The entrepreneur seeks to satisfy the requirements of the regulatory framework to maximize rents and avoid sanctions and follow normative prescriptions of socially accepted behavior and conduct, and rely on cultural values and beliefs as sources of guidance in making venture decisions.

Well-developed institutions engender a stable framework in which economic transactions can take place. In emerging economies, the evolving institutions play the counter role and the unstable frameworks actually increase the uncertainty that surrounds business. Peng and Heath (1996) noted that economic activities could only go as far as the existing institutional structures could support. For instance, the legal frameworks could only handle as many cases. The courts could be overloaded as the legal structures are inadequate to handle the magnitude of cases being filed and are therefore slow in responding to reported cases of illegal activities.

The next sections discuss the literature on the institutional framework and present the propositions. The next sections examine entrepreneurial actions and responses to the regulatory and normative frameworks. The interconnectivity and interrelatedness of these frameworks and their influences on entrepreneurial actions are further examined.

Regulatory Environment

In emerging economies, local entrepreneurs adapt to outlast unstable institutional environments. In a context of scarce resources, overbearing regulations, and inefficient bureaucracy, entrepreneurs devise coping mechanisms to increase their chances of survival and success. In like fashion, government regulations impact entrepreneurial activity in getting licenses, taxes and bureaucratic requirements. For example, many banks in Nigeria, of recent, are facing challenges and changes in their capital structure (The New Black Magazine, June 10, 2011; Samuel, Osinowo, & Chipunza, 2011). These have been ongoing issues for about four years now. Also, the concept of enforceable legal contracts is still foreign to most of the populace. Lyon and Porter (2009) described the formal regulatory system in developing countries as inadequate. Moreover, government intervention and uncertain government policies bears on the strategic responses of the local entrepreneur.

The regulatory framework defines the rules and laws by which entrepreneurial activity should take place. This framework also rewards good behavior and metes out punishment for

errant practices. Previous studies have observed that the regulatory environment of a country has profound impact on entrepreneurial activity (Chang & MacMillan, 1991). Likewise, governments' actions to reduce uncertainty in the business sector through laws and regulations boost local entrepreneurship (Nwabuzor, 2005). "Thus, governments play a key role in shaping the environments under which organizations must operate. Their actions create or moderate the uncertainties that organizations must manage, and therefore governments are able to shape organizations in powerful and important ways," (Pearce et al., 2009).

The state government is a bureaucratically-organized administrative structure charged with making laws and policies for business conduct. Bureaucracy in emerging economies have been noted to be complex, unwieldy, large, and cumbersome (World Bank, 2006). The governments in developing countries usually have considerable control over the allocation and distribution of resources either through intense oversight of resource giving enterprises such as banks or through their power of planning. The government's process for enacting policies can be confusing and difficult to understand, yet the entrepreneur must meet the requirements of many state agencies and commissions to start and stay in business.

Moreover, the regulatory system of many developing countries is marked by a lax and selective stance on the enforcement of rules and regulations. Lax enforcement of laws brings about an unstable regulatory environment that is characterized by whims and caprices of government agents. Navigating the complex myriad of laws and regulations becomes a necessary survival skill. The next sections discuss entrepreneurial responses to the bureaucratic haze and complex institutional systems.

Personal relationships with government officials

The entrepreneur's strategic response to an unstable regulatory environment is reviewed in this section. An unstable regulatory environment has been recognized as the biggest hurdle to economic growth and creates unstable environment unfriendly to business (Itegboje, 2011). Entrepreneurs then cultivate and use relationships with government officials to gain reprieve from highly bureaucratic burdens. Puffer, McCarthy, and Boisot (2009) observed that instability in the regulatory environment is often offset by reliance on relationships, trust, and a strong normative environment. What the regulatory environment lacks in terms of law enforcement and transparency in process, personal relationships with government officials make up for it. Tsang (1994) noted that private businesses in China maintained relationships with government officials in navigating the bureaucratic haze.

Strong ties come from maintaining frequent relationships with government officials, pacifying them, accommodating their desires, and seeking to satisfy their personal requirements. Strong ties with government officials is a competitive advantage as these ties provide access to inside information on potential government action that may impact businesses. These ties are relied on for protection from harassment by government officials and law-enforcement agents.

Entrepreneurs seek cordial personal relationships with government officials to maintain access to resources and to prevent harassment from government officials. Those entrepreneurs that refuse to acquiesce or cooperate with government officials risk harassment and a difficult time.

Proposition 1: The less stability an entrepreneur perceives in the regulatory environment, the stronger the personal ties with government officials.

Involvement in illegal activities

As noted above, the entrepreneur seeks and maintains ties with government officials to prevent undue law enforcement harassment. Harassment can occur in the form of businesses being arbitrarily closed down or by becoming the subject of high taxes. Entrepreneurs then find it necessary to seek rogue protection for businesses to thrive by cultivating personal relationships with government agents. Their efforts at maintaining such relationships often results in bribery. As a result of close personal ties with government officials, the line between legal and illegal activity is blurred in this context. Bribing is a major component of corruption in developing countries.

The legal system can be vague and confusing to the entrepreneur and success is determined by knowing which laws to obey and which to ignore. Many police officers and judges are beneficiaries of a corrupt system (Mbaku, 1996). Fadahunsi and Rosa (2002) also found that entrepreneurs participated in an illegal economy of bribery and corruption in Nigeria to allow them to carry out their businesses harassment-free from powerful police and custom officials.

Moreso, Welter and Smallbone (2011) emphasized that entrepreneurial behavior should be interpreted in the context in which it is observed. They noted that in challenging environments, entrepreneurs find tax evasion and bribing of officials to be a necessity as working capital is in short supply. Moreover, developing countries have low levels of economic development, which have been noted to be related to high levels of corruption (Husted, 1999).

Bribery results as a result of submitting to the more powerful external agent. The perceived lax in the enforcement of laws encourages the entrepreneur to engage in illegal business activity for business protection. This is the entrepreneur's strategic response to a powerful external body that has the authority to obstruct the business venture.

Proposition 2: The less stability an entrepreneur perceives in the regulatory environment, the greater the propensity for the entrepreneur to engage in illegal activities.

Normative Environment

The normative environment measures "the degree to which a country's residents admire entrepreneurial activity and value creative and innovative thinking," (Busenitz, Gomez, & Spencer, 2000). The normative framework describes the appropriate way to pursue goals and objectives. A shared common understanding of the rights and responsibilities, privileges, and duties of the members of a social group stems from the normative framework (Scott, 1995: 38). Specifically, the normative environment prescribes proper business conduct in a network of

business people, government officials, bankers, law enforcement officers, and justices. Those who identify with the norms adhere to the normative prescriptions and gain legitimacy.

The network is a strong normative force prescribing conduct, punishment, and rewards. The entrepreneur maintains favorable standing with network members by being seen as obeying the norms. This favorable standing becomes social capital that can be used to request access for required resources (Gulati,Nohria &, Zaheer, 2000). Entrepreneurs behave according to prescribed norms to gain and maintain access to resources. The downside of rejecting social norms is risking being regarded as a miscreant and losing access to crucial resources that will aid entrepreneurship activity. Through the perpetuating actions of entrepreneurs and other network members, the norms become the unwritten rules of appropriate behavior. Social capital can also be gained through high-profile marriages, club memberships, and church attendance. These are means by which entrepreneurs maintain strong ties and signal social status.

A good perception developed by maintaining socially constructed prescriptions confers reputation. Others' perceptions of the entrepreneur as adhering to socially-constructed rules of conduct enhance the entrepreneur's positive reputation and social status. The reputation acts as the leverage for gaining resources to advance entrepreneurial activity.

Entrepreneurs in developing countries strongly identify with the prescriptions of acceptable behavior to gain access to resources. They are not putting up an act; they imbibe these prescriptions. Particularly in a difficult institutional context such as found in developing countries in Africa and the Middle East, conforming to socially defined norms of behavior is all the more critical to access physical and financial resources. Resource holders, particularly of capital and customers, are willing to add their value to entrepreneurs that are viewed as part of the network. Zott and Huy (2007) found that those who convey their personal credibility, professional organizing, organizational achievement, and the quality of stakeholder relationships more skillfully and more frequently obtained more resources than those who did not.

Also, a positive reputation confers legitimacy, which increases likelihood of access to critical resources for business. Legitimacy is "a generalized perception that the actions of an entity conform to socially constructed system of norms, beliefs, and definitions," (Suchman, 1995: 574). For the local entrepreneur, legitimacy and acceptance by the larger community is significant for entrepreneurial growth and success. To be successful and gain legitimacy, the norms of reciprocity are maintained. Entrepreneurs ardently strive for legitimacy as this is an indication of institutional support.

Illegal business activity such as tax evasion, judicial sanctions avoidance, and bribery of government officials fosters an environment of corruption. Fadahunsi and Rosa (2002) observed that the illegality of bribing led to an illegitimate economy that was necessary to conduct business without harassment from government officials. Illegal practices were found to be long-standing and necessary that these practices had become the norm in government and business environment. The corruption had permeated every fiber of the bureaucratic system. The local entrepreneur seeking to survive in this stifling environment is left with no choice but to acquiesce. Because of being immersed in such an environment, entrepreneurs find themselves

bribing out of habit. Those who choose to resist the culture of bribery end up bribing out of imitation of others who have been successful through bribing. They observed that those who complied with the bribery requests tended to be successful and gained access to resources to advance their business. These were entrepreneurs that complied as a strategic response with socially accepted norms of bribing in this particular environment. The downside of these responses is that the culture of corruption is fostered and nurtured. Bribery of officials is necessary to engage in both legal and illegal trade (Fadahunsi & Rosa, 2002). Local entrepreneurs bribe government officials to mitigate harassment and avoid law enforcement and judicial sanctions.

Proposition 5: The strength of identification with the normative framework is positively related to involvement in illegal activities.

Conclusion

This study adds to the literature on entrepreneurship in developing countries by examining institutional influences on entrepreneurial responses in adverse and complex environments. The institutional framework bears on the success of the entrepreneur since it prescribes the context in which the entrepreneur seeks opportunities. The context also influences the availability of resources and the kind of efforts required to access these resources.

The next seemingly frontier for business activity is the Middle East and Africa and there is relatively limited management research of these contexts. Increased business and research have been turned to that part of the world. Moreover, China has been reported to have made significant investments in African nations for resources. Management scholars should then critically examine these countries' institutional profiles to increase our knowledge of these contexts as well. The application of our existing theories to these contexts is particularly appropriate to test these theories.

The paper describes entrepreneurial responses to the regulatory and normative, institutional pressures in developing countries. The regulatory institutions promote certain behaviors and discourage others. The normative institutions refer to the accepted forms of behavior and norms of the people in that environment. It refers to the moral governance of the people. These different facets of the country will influence the social and business patterns of that environment. Furthermore, the government can effectively target its efforts in strengthening regulatory frameworks and discourage inefficient routines that end up influencing normative framework.

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