

INSTITUTIONAL CONTEXT AND ENTREPRENEURIAL DYNAMISM:
CORRUPTION, DISTANCE TO FRONTIER, PERCEIVED OPPORTUNITY
AND ENTREPRENEURIAL ACTIVITY

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Abstract

The purpose of this dissertation is to explore and test a model that explains how the levels of corruption and the absolute quality of regulatory environment in ease of doing business influence entrepreneurial opportunity, and to explore the process leading to entrepreneurial intention to start a new business venture.

This dissertation hypothesizes that corruption has both beneficial and detrimental effects on the entrepreneurial opportunity, and that such relationships is contingent on different levels of overall regulatory condition in ease of doing business. Beneficial effects and positive relationship can be seen in countries with poor regulatory procedures and the opposite is true for the countries with well-established ones, a complex relationship which could be visualized as a U-shaped relationship. This dissertation further proposes that entrepreneurial perceived opportunity in turn positively relates to entrepreneurial intention, and this relationship is moderated by the facilitating effects of corruption to overcome the uncertainties and barriers in doing business.

Drawing on institutional theory, structuration theory, theory of planned behavior, and employing legacy dialog tools and regression analysis, 45 countries from different regions, political systems, economies, and population sizes are examined employing multiple data from the Global Entrepreneurial Monitor (GEM), Transparency International's Corruption Perception Index (CPI), and the World Bank Global Indicators for the period 2011. Empirical results support the *greasing the wheels hypothesis* of corruption on entrepreneurial opportunity which competes with the *sand the wheels hypothesis*, a generally accepted negative consequences perception of corruption on the economic development. A second single cross sectional data set that consists of 88

countries for the period that covers 2008-2011 is again employed to test the robustness of the results. The findings contribute to a deeper understanding of the complex influences of corruption on the process of entrepreneurship, especially on the entrepreneurial perceived opportunity and intention to start a new business venture, which further can lead to the development of optimal policies, entrepreneurial theories and practices, both in controlling corruption and promoting entrepreneurship across countries.

PREVIEW

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Chapter One

Introduction

Entrepreneurship is described as creative process where “opportunities to create future goods and services are discovered, evaluated, and exploited” (Shane and Venkataraman, 2000, p. 218). The importance of such creative process has long been recognized as a force that generates economic growth by innovation and technological revolution (Schumpeter, 1934), a process that creates an equilibrium for supply and demand (Kirzner, 1997), that transforms knowledge into products and services (Shane and Venkataraman, 2000), and an increasingly important vocation for the development of human and intellectual resources and capabilities (Zahra and Dess, 2001). A stream of research works that lend support for such important contributions of entrepreneurship to a country’s eventual economic growth have been documented by scholars (Romer, 1994).

According to Shane and Venkataraman, the root of entrepreneurial process originates from opportunity and as such opportunity is a key construct of entrepreneurship discipline where it defines the boundary and exchange conditions of entrepreneurship field, and renders an important link especially in theory development, paradigm building and empirical analysis of entrepreneurship discipline (Busenitz et al., 2003). It is even argued that there won’t be entrepreneurial activities in the absence of opportunity (Short, et al., 2010).

On one hand it is argued that institutions influence economic development through entrepreneurship (Sobel and Hall, 2008) where entrepreneurs are the resources allocator, and at the same time act as the change agents of economic development (Schumpeter, 1934).

On the other hand, corruption, an informal institution, has been a prevailing problem for the eventual economic development across nations (World Bank, 2013). One common piece of news in recent years has been a scandal of corruption in different countries and regions around the globe. This type of news has become so pervasive that cause little surprise when read. Simultaneously, we see information about the importance that creation of new enterprises has in promoting economic development and how policies and regulations directed at easing creation of new organizations are common policies in many countries. In observing both phenomena, the author began to question the effects of the former in the latter.

In other words, it is important to explore how corruption does influence the perception and following of entrepreneurial opportunities and what are the factors influencing corruption and perception of entrepreneurial opportunities in different institutional contexts and levels of entrepreneurial dynamism. Top scholars in Iberoamerica have expressed similar opinions on the importance of entrepreneurship and entrepreneurship education in promoting and enhancing quality of life and economic development in the “A life in Research” section of *Management Research*; the official Journal of the Iberoamerican Academy of Management (Ibarreche & Mesquita, 2010; Ibarreche, 2011, 2013).

While entrepreneurship acts as an important driver of the economic growth and prosperity for a country, corruption, simply defined by World Bank as “the abuse of public power for private benefit”, has been generally recognized as a complex and malignant inhibitor having negative impact on the economy and society (Tanzi, 1998). However, corruption is arguably such a complex phenomenon (Svenson, 2005) that some scholars assert that it has beneficial effects in certain type of political, cultural and social environment (Asiedu and Freeman, 2009; Dreher and Gassebner, 2007; Tanzi, 1998). Being accepted as one key element of a country’s institutions, corruption and

its relationship to other macroeconomic indicators have been widely studied by scholars where institutional theory (North, 1990; Scott, 1995) has been one foundational theory to explain these relationships and associated phenomena of corruption (Anokhin and Schulze, 2009; Blankart and Kirchner, 2003; Kaufmann and Kraay, 2003; Lambsdorff, 2003; Mauro, 1995; Rose-Ackermann, 1978, Svenson, 2005).

Policy development that attempts to tackle the chronic problem of corruption and the one that promotes entrepreneurship is one daunting challenge in many countries around the world (World Bank, 2013). The importance of entrepreneurial endeavors in creating new business ventures, promoting economic development, and determining how policies and regulations should be crafted to facilitate creation of new organizations are vital themes to policy development agendas in most countries. This dissertation intends to further examine whether there is a relationship between these two phenomena, especially how corruption influences the entrepreneurial process between perceived opportunity and intention to start a new business.

In doing so, this dissertation further focus its attention on the moderating effect of corruption on the relationship between opportunity and the resulting intention to start a new business venture. I argue that to expand our knowledge on such relationships are important for the field of entrepreneurship as a whole, and entrepreneurship education, practice, and policy development in particular, to promote and enhance quality of life and economic development of countries (Ibarreche & Mesquita, 2010; Ibarreche, 2011, 2013).

On the other hand, the roles of regulatory environment on the economic development and business activities of a country have long been recognized by scholars (North, 1990; Scott, 1995; Peng, 2003). As an index that portrays the generalized picture of a country business environment, and as a comparative measure to other countries in doing business, economic ranking of countries developed by World Bank is one of the established set of indicators that provides essential information about on business and regulatory environment on ease of starting and operating a new business in a particular country from different dimensions (Dreher and Gassebner, 2007).

Especially, “distance to frontier”, a specific ranking of a country which is an absolute measure of how far the distance of a country standing for different criteria in doing business, comparing to the best performer in that particular criteria, provides a direct and simple comparative information on “how easy or difficult to start a business” (World Bank Doing Business, 2012), and an indirect information on overall regulatory and institutional context of that particular country. An index of 100 is the best frontier a country could achieved and a country with the scores of 80 is 20 points away from the best practices. However, whether there is a significant difference in levels of opportunity perceived by entrepreneurs in different levels of corruption and regulatory environment, and the exact nature of the process the opportunity influences on entrepreneurial intention and resulting activities is still unexplored research area.

As mentioned above, entrepreneurship is indeed a process which begins with identifying opportunity where opportunity, according to Locke and Latham (2004), is “a certain aspects of the environment that represent potentialities for profit making”. Shane and Venkataraman (2000, p. 220) define entrepreneurial opportunities as “situations in which new goods, services, raw materials, and organizing methods can be introduced and sold at greater than the cost of their production”. Shane (2009) acclaims that opportunities determine the entrepreneurial process since

it is the starting point for an entrepreneur to exploit these opportunities to realize potential tangible or intangible benefits.

On the other hand since different people have different resources and capabilities, not all people have same level of intention to pursue nor able to take advantage such opportunities. In such situation perceived opportunities even may become irrelevant (Aldrich and Zimmer, 1986). According to Venkataraman (1997), an opportunity is only valuable when it has potential to generate profit by earning “revenue that exceeds the entrepreneur’s opportunity cost, a premium for the illiquidity of money, time, and effort expended, and a premium for bearing risk and uncertainty”, a phenomena that can be explained by institutional theory.

People in countries with different level of corruption and regulatory environments influencing on the risk, uncertainty and cost of opportunity, may have different level of perception on opportunities. Further, depending on the differences in capabilities possessed and level of intention to engage in a process of entrepreneurial activities, supported by social influence, could determine the outcome of entrepreneurial activities.

Extant researches on entrepreneurship have well documented the relationships among macro level environmental forces (Aldrich, 2000), the entrepreneurial traits and their characteristics and entrepreneurial activities (Christiansen, 1997). While such researches have expanded existing knowledge on entrepreneurial process contributing to the eventual economic development of a country, it fails to consider the one specific role of regulatory and institutional context; how people’s perception on corruption and its ranking on “distance to frontier” of doing business influence on the perceived opportunity and the entrepreneurial process between

opportunity identification and the eventual development of entrepreneurial activities across countries. This is the specific knowledge gap this dissertation intends to focus.

Drawing from theory of planned behavior (Ajzen, 1991), the intention to start a new business is a function of entrepreneurial perceived opportunity, entrepreneur perception about his or her abilities, and the intensity of social norm which in turn being influenced by external environmental factors such as corrupt business and regulatory environment (Locke and Latham, 2004).

This study proposes that the entrepreneurial activity is directly related to entrepreneurial intention which in turn is partially a function of perceived opportunity, perceived capabilities, social influence and, and partially moderated by a function of institutional context, in which corruption is one important element, and regulatory environment, particularly, distance to frontier is one important indicator.

Although constructs related to corruption, global economic ranking in doing business and entrepreneurial activities have been analyzed independently, research on their relationship, specifically to the process between perceived opportunity and entrepreneurial activity, regarding to the ranking of “distance to Frontier” and corruption level of a country is, to the best of author’s knowledge, a research gap. To fill in this gap, this study proposes that a timely scholarly investigation to into this research area is imperative and has important implications and contribution on the existing knowledge of entrepreneurship and institution.

Drawing from institutional theory (North, 1991), structuration theory (Giddens, 1984), and theory of planned behavior (Ajzen, 1988), this study employs a set of regression analyses to test the propositions, using multiple data from Transparency International’s Corruption Perception

Index (CPI), World Bank's "Distance to Frontier" ranking, and data from Global Entrepreneur Monitor (GEM), focusing on two sets of sample data. The first data set includes a sample of forty-five countries for the year 2011, and the second data set covers a cross-sectional panel data of 88 countries for the period that covers from 2008 to 2012 is employed to test the robustness of the findings from first data set.

In the remaining parts, chapter two provides literature review, theory development and proposed conceptual research model on variables under investigation which are: corruption based on the perception of corruption, regulatory environment proxy to World Bank's distance to frontier index, entrepreneurial perceived opportunity, perceived capabilities, entrepreneurial intention, and nascent entrepreneurial activity. In chapter three, development of sample data sets will be explained and proposed model of the relationships will be tested. The last chapter of this dissertation discusses the results of the empirical analysis and their implication and contribution on theoretical development and practical aspects such as policy development issues, and it concludes with discussion on limitations and future research potential.