

## Entrepreneurship in post-socialist economies: A typology and institutional contexts for market entrepreneurship

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### **Abstract:**

There is growing recognition among post-socialist (PS) economies that free-market entrepreneurship is essential for ultimately improving their economic future. The promotion of market entrepreneurship, however, has been a challenging experience for these economies. This paper examines various forms of entrepreneurship in PS economies. Drawing upon the institutional theory, we also highlight the clear contexts and attendant mechanisms associated with institutions—entrepreneurship nexus in PS economies' contexts.

**Keywords:** Post-socialist economies, Institutions, Political entrepreneurship, Unproductive and destructive entrepreneurship, Legitimacy, Deinstitutionalization

### **Article:**

#### ***Introduction***

There is growing recognition among post-socialist (PS) economies that free-market entrepreneurship is essential for ultimately improving their economic future. For this reason, governments in Central and Eastern European economies (CEE; Stoica 2004), China (Kshetri 2007; Segal 2004; Schramm 2004), and Vietnam (Reed 2004) are encouraging free-market entrepreneurship. Yet these economies are far from free market ones (e.g., see Surowiecki 2007 for China). The transition to market economy has proven to be a challenging experience for these economies. This is because of the absence of and difficult to construct appropriate political, legal, economic, and commercial structures needed for a free market economy (Blawatt 1995; Tyson et al. 1994; Smallbone and Welter 2001; Mugler 2000; Warner and Daugherty 2004).

While PS economies do not lack entrepreneurship talents, there has been a lack of institutional supports needed to promote productive free-market entrepreneurship. For one thing, political entrepreneurship, in which entrepreneurs use political power, capital, and social networks to maximize economic rewards (Hankiss 1990; Staniszki 1991; So 2003; Stoica 2004), is more readily apparent in PS economies than in mature market economies. Moreover, as is the case of other developing economies (e.g., see McGaffey 1987 for Zaire), the ruling elites and their family, friends, and clients have lived a parasitic existence in some cases in PS economies. Beyond all that underground and informal economies associated with criminal and quasi-criminal activities are sizable in these economies (Kwok 2007; O'Rourke 2000; Warner and Daugherty 2004). Note that political entrepreneurs receive state subsidies and contracts in various forms and are associated with inefficiency (Burton 1987). A related point is that conversion of "informal economy" to free enterprise is a critical practical challenge facing PS economies as well as other emerging economies (De Soto 1989).

Transition from central plan to free market is a complicated process requiring economic, political, and social transformations for PS economies. These economies also differ drastically in terms of amount and nature of such transformations. While some economies have made a quantum leap on that front, institutional changes seem to be more of an upward drift rather than a surge in others' cases. At the same time, there is no clear

definition of the type of market economy desired by these economies (Hisrich and Fulop 1995).

In a rich body of theory and empirical research, scholars have examined the context of entrepreneurship in PS economies (e.g., Feige 1997; Hsu 2006; Negoita 2006; OECD 2002; Stark 1992; Stoica 2004; Tsai 2006; Yang 2002; Zweynert and Goldschmidt 2006). Unfortunately, most attempts to study entrepreneurship in these economies have not provided how various forms of entrepreneurship in these economies are related. The literature is also often plagued with claims and counter claims regarding the environment in these economies from the standpoint of the promotion of market entrepreneurship. Consider, for instance, institutional supports for entrepreneurship in China. One view is that as is the case in a number of other Asian economies, China is “shifting from top-down, state-directed technology policies to more flexible, market-oriented approaches that foster innovation and entrepreneurship” (Segal 2004) and is adopting policies that actively encourage entrepreneurship (Schramm 2004). The opposite argument is that China's emerging entrepreneurs are far from free market ones and are generally supportive of the Chinese Communist Party's (CCP) authoritarian agenda of “unity and stability” (Pei 2006). Put differently, they have characteristics of political entrepreneurs.

Notably lacking from this literature is also explicit attention to motivations and mechanisms associated with various forms of entrepreneurship activities. How free-market economy can be promoted to enable businesses to compete in the global market and provide benefits to a broader range of people in these economies is a pressing policy and theoretical issue that adjoins larger political concerns of PS societies as well as broad-based substantive interests within various social science disciplines.

The purpose of this study is to highlight the clear contexts and attendant mechanisms associated with entrepreneurial forms in PS economies. To do so, we provide an explanatory analysis of various forms of entrepreneurship and institutions—entrepreneurship nexus in PS economies. The current work supplements previous entrepreneurship studies related to demand-side perspective of entrepreneurship (Thornton 1999; Venkataraman 1997; Shane and Venkataraman 2000), institutional aspect of international entrepreneurship (e.g., Kostova 1997) and those in the context of PS economies (e.g., Hankiss 1990; Staniszkis 1991) by providing new insights on the typology of entrepreneurs in these economies and mechanisms associated with the stimulation of market entrepreneurship and conversion of nonproductive entrepreneurship to market entrepreneurship. By doing so, this study also responds to calls for more comparative research on international entrepreneurship (Coviello and Jones 2004; Spence and Crick 2006).

It is recognized that the resource-based view (Wernerfelt 1984; Barney 1991) offers an important theoretical basis for international entrepreneurship research (Wilkinson 2006). In this regard, it is important to note that there are many “convergent assumptions” between the resource-based view and institutional theory (Oliver 1991, p. 146). The underlying notion in this paper is that institutional theory is likely to provide novel and unique insights in international entrepreneurship research.

Before proceeding, we offer a definition. An economic and social system is considered to be conducive to free-market entrepreneurship if the means of production are mostly privately owned and a market economy operates, that is, decisions are influenced by competition, supply, and demand (Schrems 2004). In the remainder of the paper, we first discuss various forms of entrepreneurship in post-socialist economies. Then, we develop some propositions related to institutions-entrepreneurship nexus. The final section provides discussion and implications.

### **Productive, unproductive, and destructive entrepreneurship in various forms in PS economies**

Before we proceed, it is important to note one thing: PS economies did not have a lack of entrepreneurial talent in the central planning era. For instance, the Chinese Communist Party maintained political dominance thanks mainly to entrepreneurs that were highly innovative in carrying out state plans to build industries and launch new enterprises (Yang 2002). “Reemergence” of private entrepreneurship (Guiheux 2006) in PS economies, however, is a recent phenomenon.

Second, individuals in PS economies do not necessarily have a lower propensity to engage in entrepreneurial activities than those in matured market economies. Before proceeding further, it is important to note that, in prior research, scholars have implicitly or explicitly referred self-employment as associated with entrepreneurship (Bradford 2007; Cranford et al. 2005; Fajnzylber et al. 2006; Hamilton 2000; Mora and Dávila 2006; Yunus 2007). According to the International Social Survey Program dataset, the proportion saying “I would prefer to be self-employed” was the largest in Poland—80% (Blanchflower et al. 2001). However, it is also important to note an important caveat. Prior research has also indicated that an individual’s intention to engage in self-employment does not necessarily indicate the presence of entrepreneurial talent with the individual. For instance, the study of Carter et al. (2003) found that nascent entrepreneurs—those who were in the initial stages of starting a business—“were more similar to non-entrepreneurs than they were different”.

Of equal importance in the discussion of entrepreneurship development in PS economies is the acceptance of capitalism, at least symbolically, by the population. For instance, in a survey, about 80% of young Russians said that they have “successfully adapted to capitalism” (Nikitina 2004, p. 26).

To be sure, the concept of entrepreneurship is, however, quite broad in PS economies. Indeed, as noted earlier, entrepreneurs in PS economies have come in various forms. One way to classify entrepreneurial activities is in terms of their legalities. There have been an increasing number of businesses within the legal boundary. In rapidly changing environments like those of PS economies, however, entrepreneurs find attractive economic niches from outside the current institutional boundaries (Yang 2002, 2004). A significant proportion of entrepreneurial activities in these economies have been in “quasi-legal and extralegal gray areas” (Tsai 2006, p. 127). More broadly, speaking of entrepreneurship in developing economies, De Soto (2000) forcefully concludes, “Extralegality has become the norm”.

A related point is that inertia effects of socialism influences entrepreneurial activities in PS economies. In this regard, one broad observation made by Stark (1996) shapes everything that follows: “capitalism is built not on but with the ruins of socialism”. Socialism’s ruins come in various forms including the influence of MarxLeninism philosophy and the prominence of communist party members and bureaucrats in the entrepreneurship landscape.

Based on the two dimensions discussed above—legality and inertia effects of socialism—we have developed a 2 × 2 typology of entrepreneur types in post-socialist economies (Table 1).

Our observations above also raise the interesting possibility that institutions in PS economies may do better in promoting entrepreneurship in unproductive and destructive forms than those in matured market economies. Note that in prior theoretical and empirical research, scholars have employed the concept of productive, unproductive, and destructive entrepreneurship from a social point of view (Baumol 1990; Hall and Rosson 2006). In a justly influential paper, Baumol (1990, pp. 897–898) states: “If entrepreneurs are defined, simply, to be persons who are ingenious and creative in finding ways that add value to their own wealth, power, and prestige, then it is to be expected that not all of them will be overly concerned with whether an activity that achieves these goals adds much or little to the social product or, for that matter, even whether it is an actual impediment to production...”.

**Table 1** Entrepreneurship in post-socialist economies: a typology

Ideology	Legality	
	Legal	Non-legal
Socialism dominated	Collective entrepreneurship	Elite entrepreneurship Political entrepreneurship Red hat entrepreneurship
Capitalism dominated	Market entrepreneurship	Institutional entrepreneurship

The underlying notion in this paper is that free-market entrepreneurship, which relies on competition, supply,

and demand (Schrems 2004), is likely to add to the social product and hence is productive. Political entrepreneurship, which is associated with criminal and quasi-criminal activities (Kwok 2007; O'Rourke 2000; Warner and Daugherty 2004) and inefficiency (Burton 1987), on the other hand, tend to be unproductive or even destructive. Note that in destructive entrepreneurship, entrepreneurs are engaged in detrimental activities such as those related to criminal behaviors, which lead to net social loss (Hall and Rosson 2006).

### **Productive market entrepreneurship**

Market entrepreneurs depend upon the newly created market institutions. While economic systems in matured market economies are characterized by "private enterprise" and market entrepreneurship (Benton 1987), this form of entrepreneurship is at the early stage of development in PS economies. Contrary to the stereotypically different expectations that surround PS economies, however, market entrepreneurship is growing rapidly in these economies. Commenting on China, Richter (2000) noted that new entrepreneurs increasingly resemble "market entrepreneurs" and are moving away from depending on political connection.

In recent years, overseas Chinese returnees, especially from Europe and the USA, have started developing complex and dense social organizations and institutions to promote market institutions. Compared to Chinese entrepreneurs who have stayed in China for their whole life, these "returnees" fare better in terms of different components of market entrepreneurship such as understanding of the roles of private equity, other forms of financing and risk-taking behavior (Kambil et al. 2006; Moore 1997). Wang (2001) documented the evolution of a "club culture" in China, which has promoted innovation and risk taking and stimulated interaction among various ingredients of entrepreneurship. In a process known as "brain circulation", Saxenian (2005) describes how Chinese engineers and entrepreneurs with work experience in Silicon Valley are contributing to entrepreneurial development in their home countries. They initially enjoyed home-country advantage by tapping the low-cost skill base and subsequently moved into a higher gear and engaged in the localized processes of "entrepreneurial experimentation and upgrading" (p. 35). Such a culture is especially evident in industrial and high-tech parks of the country (Loyalka and Dammon 2006). Other studies have found that overseas Chinese have contributed in producing synergies and in "thickening" existing institutions (Amin and Thrift 1995, p. 102; Keeble et al. 1999).

Similarly, across many studies, we now have evidence of gradual change in traditional Russian business values and emergence of values more consistent with free-market entrepreneurship (Elenkov 1997; May et al. 2005; McCarthy and Puffer 2008; Starikov 1996; Veiga et al. 1995). For instance, as early as in the mid-1990s, in Russia, there were some venture capital-funded "technologically well-equipped, innovative firms employing personnel with extremely high scientific and overall cultural levels" (Starikov 1996).

It is also argued that a significant proportion of small and self-employed firms in PS economies have ingredients of market entrepreneurship in their functioning (Daokui et al. 2006). As of 2005, China had 24 million small independent companies and the number was growing at 15–20% annually (Loyalka and Dammon 2006). During 1988–1995, an estimated 30 million self-employed workers emerged in rural China (Rozelle et al. 1999), and self-employment grew even faster in the coastal provinces (Mohapatra et al. 2007).

### **Unproductive and destructive entrepreneurship**

It is reasonable to expect that compared to more matured market economies, unproductive and destructive forms of entrepreneurship are likely to be more prevalent in PS economies. In prior research, scholars have examined a range of criminal and quasi-criminal activities in PS economies (Kwok 2007; Warner and Daugherty 2004). For one thing, the introduction of market forces in PS economy pushed a great deal of economic activity to underground (Kwok 2007). In Tajikistan, for instance, black market accounted for 95% of retail activity in the first half of 1997 and 50–60% in Ukraine (O'Rourke 2000). According to Goskomstat, Russia's State Statistics Service, unreported income accounted for 30% of wages paid in the late 1990s in the country (Kwok 2007). The corresponding figure for Bulgaria is estimated at about one third (O'Rourke 2000). Similarly, according to the Romanian Information Service, the size of unofficial economic activities in the country is about 30–40% of GDP and in 1998, the size of smuggling was 12% higher than that of official import. Other estimates suggest

that the “shadow economy” accounts for about 24% of GDP in Lithuania and 40% in Russia (O'Rourke 2000).

The underground economy as a proportion of GDP is significantly bigger than corresponding figures for EU member countries<sup>2</sup>. Yet, having said this, it is apparent, too, that criminal and illegal enterprises also generate positive externalities in some cases. Fishman (2005) for instance notes that the underground economy has provided a supply of desperately needed cash to the Chinese economy.

Finally, a remarkable example of “parasitical existence” (Baumol 1990, p. 894) of entrepreneurs upon the economy is the creation of firms to support criminal activities in some PS economies, especially in Russia. There are companies whose primary purpose is to provide money laundering services for criminal organizations (Kuznetsov et al. 2000). Organized crime groups in Russia have been the driving force behind the rapid rise of global cybercrime. For instance, the Russian Business Network reportedly sells website hosting services to cyber-criminals ([Economist.com](http://Economist.com) 2007; Krebs 2007). These activities powerfully illustrate the prevalence of destructive entrepreneurship, in which entrepreneurs are engaged in detrimental activities which lead to net social loss (Hall and Rosson 2006).

### **Political entrepreneurship**

Stark (1996) makes an intriguing argument as to how political entrepreneurs emerge in PS economies: post-socialist transition is not a transition from plan to market but from plan to clan. The essence of the argument is simple: political entrepreneurs take advantage of their positional power to maximize economic rewards. This emphasis on the exploitation of positional power is echoed in the “political capitalism” thesis, which argues that major winners of the PS transformations are the former nomenklatura (Hankiss 1990; Staniszki 1991). Political entrepreneurship thus goes against the idea of capitalism and describes a paradoxical situation of “making capitalism without capitalists” (Eyal et al. 1998).

While political entrepreneurship also exists in mature market economies, this form of entrepreneurship is more readily apparent in PS economies. A central feature of the privatization of state enterprises in these economies is that privileged elites converted “limited de facto use and income rights into more de jure alienable rights” (Feige 1997). It is argued that Russia’s “prearranged privatization” is “deeply flawed” (Brovkin 2001). Following the mass privatization, former nomenklatura appointees accounted for about two-thirds of the top positions in businesses and the government in the country (Lazarev 2005). Some argue that Russian economy is a hybrid between Soviet capitalism and feudalism (Brovkin 2001; Ericson 2000). Likewise, beginning in the mid-1980s in Hungary and Poland and in the late 1980s in Romania, political and administrative elites capitalized on their positional power to start their own businesses (Stoica 2004).

China’s red hat entrepreneurs are a form of political entrepreneurs. In China, the practice of registering an enterprise as a collective enterprise (see below), which is a private enterprise in reality, is known as “wearing a red hat” (dai hongmaozi; Peng 2004). In certain localities, 90–95% of registered collective enterprises were not genuine, or they were red hat enterprises (Tsai 2006). It is important to note that collective enterprises were “politically correct” and provided important access to public resources such as funds and land (Peng 2004).

In China, cadres thus took advantage of the nascent business opportunities thanks to political capital and their social networks (So 2003). Indeed, one important way for entrepreneurs to “avoid social and political ostracism” was to wear a red hat (Tsai 2006). An uncomfortable reality, however, was that many cadre entrepreneurs that developed profitable collective enterprises quit their official positions and set up their own capitalist enterprises. They hired their kin and friends to run them (So 2003). One way to overcome bureaucratic red tape has been to be close to the CCP in order to gain advantages and preferential treatments (Guiheux 2006). A membership in CCP would give an entrepreneur easier access to loans and official protection and discourages the entry of new players in the market (Guiheux 2006).

One of the most straightforward explanations for the growth of the Red hat operations, especially during the first decade of economic reform, was that private enterprises with more than eight employees (siying qiye) were

not legally permitted that time (Tsai 2006). Beyond all that, wearing a red hat was also important because private entrepreneurs were the usual suspects in the eyes of the conservative faction of the CCP. Following the 1989 Tiananmen events, for instance, the conservative faction's actions severely impacted private entrepreneurs. Estimates suggest that the number of private enterprises reduced by 50% that year (Ling 1998).

Until 1988, China's private sector consisted of only "individual households" (getihu) with less than eight employees. Many private businesses, however, registered themselves as "collective enterprises" (Li et al. 2006). A large proportion of the collective enterprises thus were larger private businesses "wearing red hats" (Tsai 2006). Indeed, many red hat entrepreneurs performed nearly flawlessly in China's rapidly changing economy.

That is not to say that political entrepreneurship is absent in mature market economies such as the USA. The concept of manifest and latent functions (Merton 1968) related to entrepreneurship can be very helpful in understanding how the nature of political entrepreneurship differs in PS and more matured market economies<sup>3</sup>. Manifest functions are explicitly stated and understood by the participants in the relevant action and the consequences can be observed or expected. Latent functions are those that are not explicitly stated, recognized, or intended by the people involved (Merton 1968). In the USA, for instance, the manifest posture is of private enterprise, but below the surface deeply ingrained are a wide range of firms that are politically dependent. For instance, according to the Center for Responsive Politics, candidates for the US congress and presidency received over \$12 million between 1989 and 2000 from the sugar industry (Ebbeling et al. 2002). Loewenberg (2000) points to the possibility that these political contributions might have an adverse effect on regulatory efforts to revise national nutritional policy. Likewise, Rivoli (2005) has illustrated how large firms in the US textile industry have received institutional favors in various forms such as subsidies and barriers to trade in textile products and thus benefited from political entrepreneurship. In China, on the other hand, the manifest posture is that of the collective enterprise while the latent reality is privatized enterprise owned by political entrepreneurs.

There are, however, important differences between political entrepreneurship in PS economies and matured market economies. Part of the fascinating character of political entrepreneurship in PS economies stems from the fact that there is a "symbiosis between economic and political elites" (Herrmann-Pillath 2006), where political entrepreneurs take advantage of positional power to maximize economic rewards (Hankiss 1990; Staniszkis 1991; Stoica 2004). In some cases, bureaucrats, who are also capitalists, may "buy" agents to penetrate into the government apparatus (Chen 2002). This situation is similar to economies in the Middle East (Kshetri and Ajami 2008) and is different from more matured market economies, in which economic and political elites tend to be different groups.

Studies conducted in China (Pei 2006), Russia, and Eastern European economies (Shevtsova 2004; Thomas 1997) have found that the most important barrier to transition to free-market economy centered on Communist Party bureaucrats' resistance. This phenomenon is similar to that in the Middle East, where bureaucrats discourage policies favoring institutional reforms (Atkine 2006) and remain a strong anti-reform force (Friedman 1997).

Another way of viewing political entrepreneurship is in terms of the entrepreneurs' engagement in central versus peripheral positions. "Resource-rich central players" (Greenwood and Suddaby 2006) embedded within their institutional contexts tend to be political entrepreneurs in PS economies. In more mature market economies, on the other hand, political entrepreneurs tend to be "less embedded organizations at the periphery" (Greenwood and Suddaby 2006).

A final issue that deserves mention relates to nepotism's influence on political entrepreneurship. As is the case of the Arab world (Izraeli 1997), such a tendency can be attributed to the culture (e.g., strong kinship ties and obligations to family and friends). This further confirms Stark's (1996) observation—PS transition is a transition from plan to clan. While some degree of nepotism is involved everywhere, influences of favoritism, nepotism, and personal connections are more readily apparent in some PS economies (e.g., China).

### ***Blurred boundary between political entrepreneurship and institutional entrepreneurship***

The research literature provides abundant evidence that actors with key strategic resources or power have significant impacts on the evolution of institutions and institutional fields (Lawrence and Suddaby 2006). Institutional researchers have come up with the influential concept of institutional entrepreneurship to examine the role of these actors in creating new institutions (DiMaggio 1988). DiMaggio (1988, p. 14) notes that “new institutions arise when organized actors with sufficient resources (institutional entrepreneurs) see in them an opportunity to realize interests that they value highly”. Institutional entrepreneurs are “interest-driven, aware, and calculative” (Greenwood and Suddaby 2006, p. 29).

A growing number of studies suggest that entrepreneurs can change particular models of social or economic orders in the process of starting or expanding businesses (Bartley 2007; Daokui et al. 2006; Svejnova et al. 2007). Daokui et al. (2006, p. 358) define such entrepreneurs as those “who not only play the role of traditional entrepreneurs in the Schumpeterian sense, but also help establish market institutions in the process of their business activities”. For the PS economies’ context, the most relevant issue concerns institutional holes. Prior researchers have framed institutional entrepreneurs as associated with and facilitated by “institutional holes”. Yang (2004) defines “institutional holes” as “structural gaps” between institutional actors located in different institutional fields that “are in control of potentially complementary resources” (Yang 2004).

Institutional holes and hence the nature of institutional entrepreneurship differ across institutional settings. In general, such holes tend to be more prevalent in PS economies, and transitional economies in general, than in developed economies because institutional rules in the former group are “incomplete, ambiguous or conflicting with one another” (Yang 2004). In many emerging economies, institutional entrepreneurs’ access to political resources facilitates their attempts to create new market institutions (Groenewegen and van der Steen 2007).

Institutional entrepreneurship in PS economies may entail illegal activities and represents a significant component of political entrepreneurship. A visible example is the *Ex Ante Investment with Ex Post Justification (EIEJ)* approach of Daokui et al. (2006) to institutional entrepreneurship. In this form of entrepreneurship, as it happens, an entrepreneur starts or expands a business by “evading existing restrictive laws or regulations” (Daokui et al. 2006). When the business becomes successful and generates social benefits, the entrepreneur reports the business to the government and persuades to change existing laws and regulations. In such cases, access to political resources is critical to succeed.

### ***Political entrepreneurship hidden inside collective entrepreneurship***

China is the most spectacular example of an economy that promoted collective enterprises. According to the official definition, all community residents were a collective enterprise’s nominal owners and the community government was the “de facto executive owner” of such an enterprise (Peng 2004). Local government’s ownership of collective enterprises was compatible with local as well as national governments’ interests (Marangos 2005). Cadre entrepreneurs managed collective enterprises (Peng 2004).

China’s collective enterprises were outside the purview of central plan and their growth depended heavily on markets (Tsai 2006). Nee (1992, p. 7) notes: “Collective enterprises quickly oriented their production to the marketplace and contributed to the rapid expansion of markets in China”. Especially, during the first decade of the economic reforms, cadres converted the collective enterprises into profitable enterprises and some also developed joint ventures with foreign and overseas Chinese capitalists (So 2003).

The latent and manifest functions discussed above can be very helpful in describing collective entrepreneurship in China. While manifest posture of entrepreneurship for collective enterprises was collective entrepreneurship, the latent form for most of them was political entrepreneurship.

### ***Variation across PS economies in terms of different forms of entrepreneurship***

It would be erroneous to assume that institutions needed to support market entrepreneurship will develop at the same rate across the PS economies. While some PS economies have made some great leaps on this front, the

reform process has been relatively slow in others. China, for instance, has failed to reform its political institutions but has been reasonably successful in constructing economic and market institutions needed to encourage innovation and entrepreneurship (Nee 1992, p. 1; Overholt 1994, p. 29; Segal 2004; Schramm 2004).

There is more variation across CEE economies' reforms than many analysts predicted (Fischer et al. 1996; Spenner and Jones 1998). In particular, Hungary and Poland are described as examples of the post-1989 successful economies. Romania and Russia, on the other hand, fall behind most PS economies. Stoica's (2004) study indicated the evidence of profound change in the entrepreneurial landscape more readily apparent in Hungary and Poland compared to that in Russia and Romania. To put things in context, Hungary has one of the most developed venture capital market among CEE economies and entrepreneurial infrastructures and services provide entrepreneurs with access to skills and expertise (Wright et al. 1999). These can be attributed to Hungary's entrepreneurship-friendly institutions. Romania's development, on the other hand, is referred as "stalled" or even "de-development" (Meurs and Ranasinghe 2003; Negoita 2006).

Likewise, the OECD Observer noted in 1999 that Poland had about two million small businesses that year, which compared with 850,000 in Russia. Note too that Russia has about four times as many people as in Poland. Skidelsky (2000) argues that PS Russia was poor because of "the absence of any secure private property rights at all—a result of eighty years of communism". Aron (2002) more forcefully argues that the communism "destroyed the key elements of the infrastructure of modern capitalism—the sanctity of the contract, the impartial court, the transparency and accountability of commercial organizations, banks as a source of venture capital, and stock exchanges—and had done all to prevent their re-emergence". Others note that a weak financial sector and a lack of entrepreneurial skills hindered venture capital inflow in Russia (Cervantes and Malkin 2001).

### **Institutional environment for market entrepreneurship in PS economies**

Baumol (1990) hypothesized that the distribution of productive, unproductive, and destructive forms of entrepreneurship in a society is a function of the "relative payoffs" offered by the society's "rules of the game". Institutionalists use formal and informal institutions to capture such rules (North 1990, 1996). North (1996, p. 344) defines institutions as "formal constraints (rules, laws, constitutions), informal constraints (norms of behavior, conventions, and self-imposed codes of conduct), and their enforcement characteristics".

Formal and informal institutions can be described in terms of Scott's (1995, 2001) three pillars—regulative, normative, and cognitive. Legal and regulatory infrastructures related to entrepreneurship describe the nature of regulative pillar (Hoffman 1999). Commenting on regulative institutions' limitations to govern organizational behaviors, Edelman and Suchman (1997) note: "the legal rules "cause" the organizational practices (or vice versa) is, at best, a gross simplification". Put differently, responses to external pressures are functions of social construction. The normative institutional pillar related to entrepreneurship introduces social and ethical dimensions. Finally, the cognitive pillar captures culturally supported belief about various ingredients of entrepreneurship.

As noted above, the issue here is not that PS economies lack entrepreneurship talents but that a significant proportion of entrepreneurial ventures in these economies lack the characteristics of productive free-market entrepreneurship. The real question, then, is what conditions can transform the rules of the game so that various forms of unproductive and inefficient forms of entrepreneurship can be converted into productive and efficient free-market entrepreneurship.

For one thing, overcoming institutional inertia (White 1992) related to socialist ancestry has been a major problem in the development of institutions to promote free-market entrepreneurship in PS economies. Speaking of the problems in transplanting Western institutions in East European economies, Offe (1996) notes: "the newly founded institutions .. fail[ed] to perform in anticipated ways" because of "unreconstructed mental and moral dispositions inherited from the old regime" (p. 212). Indeed, more broadly, the Marxist tendency has had a strong influence on the ideological and political environment of developing nations (De Soto 2000).



Prior researchers have noted that attempts to promote entrepreneurship in PS economies face three crucial challenges (Warner and Daugherty 2004). The first is cognitive frames related to skills and psychology needed for risk taking. A second barrier relates to a lack of cultural support to free-market entrepreneurship. Societal norms and social networks that provide support for entrepreneurial risk taking in matured markets are lacking in PS economies (Warner and Daugherty 2004). A final set of issues concerns the deficiency of formal institutions to support the functioning of the market (Tyson et al. 1994; Smallbone and Welter 2001; Mugler 2000; Warner and Daugherty 2004). Speaking of China about these issues, McGregor (2005) notes that cultural, social, and psychological barriers have hindered the country's progress towards market entrepreneurship.

Most obviously, promotion of productive free-market entrepreneurship in PS economies requires drastic changes in formal and informal institutions. Prior researchers have noted three institutional change mechanisms: institution formation, deinstitutionalization, and reinstitutionalization (Jepperson 1991; Scott 2001). These mechanisms are described in terms of institutional logics, which are the organizing principles that provide guidelines for actors' behaviors (Friedland and Alford 1991). Put differently, such logics create "distinctive categories, beliefs, expectations, and motives and thereby constitute the social identity of actors" (Rao et al. 2003).

### **Regulative institutions and entrepreneurship in PS economies**

Regulative institutions consist of "explicit regulative processes: rule setting, monitoring, and sanctioning activities" (Scott 1995, p. 35). They are related to regulatory bodies and the existing laws and rules that influence entrepreneurship. These institutions focus on pragmatic legitimacy concerns in managing the demands of regulators and governments (Kelman 1987). Individuals and organizations adhere to them so that they would not suffer the penalty for non-compliance (Hoffman 1999).

### **Rule of law and market entrepreneurship**

Different theoretical contributions and various empirical studies have led to the accepted view that in overly politicized and less free states, entrepreneurial efforts are diverted away from wealth creation into non-market behaviors, which entail securing protection from market forces (Campbell and Rogers 2007; Clark and Lee 2006; Kreft and Sobel 2005; Sobel et al. 2007). Such a phenomenon is readily apparent in PS economies due to a weak rule of law.

A strong rule of law is characterized by effective punishment of transgressors and sanctions for defectors (Oxley and Yeung 2001). In many emerging economies, the rule of law is "often weakly developed" or sometimes "ignored with impunity" (Bratton 2007). Most of the wealth in these economies is in the form of "informal" ownership outside the formal legal system, and hence is not recognized or enforced in the form of legal titles (De Soto 2000). Most obviously, because of ineffective legal enforcement of private property rights, entrepreneurs have to acquire political and administrative protection or depend on informal networks for security (Yang 2002). The absence of institutions to protect property rights and strong judicial system thus hinders the growth of private entrepreneurship. In the absence of mechanisms to protect intellectual property and discourage monopolies and unfair trade practices, market entrepreneurship cannot thrive (Schramm 2004). Kreft and Sobel (2005, p. 604) forcefully argue:

Creative individuals are more likely to engage in the creation of new wealth through productive market entrepreneurship. In areas without these institutions, creative individuals are more likely to engage in attempts to capture transfers of existing wealth through unproductive political entrepreneurship.

Strengthening the rule of law, however, is not just a matter of enacting new laws and regulations (Weber 1978). For instance, China has been undergoing legal reforms for three decades and most of its laws resemble those of Western countries (He 2005). Compared to developed countries the extent of noncompliance with laws and regulations is, however, more noticeable in China (He 2005). The most glaring shortcoming of regulative institutions in China is thus an absence of effective procedural and remedial mechanisms, which has hindered innovation. A complaint often heard is that China's counterfeit market discourages innovators because of a lack

of the protection of intellectual property rights (Fishman 2005).

The government's inability to strengthen the rule of law also raises the interesting possibility that some market entrepreneurs may go underground and many others into political entrepreneurs and rent-seeking activities (Alexeev 1999). Most private actors may be tempted to exploit short-term profit making opportunities under the existing institutional arrangement rather than from engaging in long-term efforts at building new institutions (Spicer et al. 2000). This is the obvious challenge for promoting market entrepreneurship in most post-socialist economies. In line with these arguments, the following is presented:

*P<sub>1</sub>: A strong rule of law encourages market entrepreneurship in PS economies.*

### **The government's basis of legitimacy**

A shift of the basis of legitimacy from MarxLeninism to economic development is critical for the success of private entrepreneurship. To substantiate this claim, we began by considering the changing basis of legitimacy in China. The conservative faction in the CCP, whose basis of legitimacy concerns MarxLeninism, considers entrepreneurial ventures as potential threats to the party's ideology, authority, and moral standards (Yang 2002). Leaders of this faction perceive improved legal institutions as potential challenges for the CCP's legitimacy (Potter 2004) and have attempted to employ rising income gap and social unrest to justify measures against private entrepreneurs (Kahn 2006). In the 1980s and the early 1990s, private entrepreneurs suffered discrimination and faced political persecution for their profit oriented behavior (Tsai 2006; Li et al. 2006). Some analysts argue that the delay in granting full rights to entrepreneurs reflects "ideological rigidity and institutional inertia against changes" (Peng 2004).

With the weakening of socialism in China, the basis of legitimacy has shifted to economic development and nationalism (Oksenberg 1987; Christensen 1996; Sautman 2001). Many CCP and state documents and social science publications officially censored by the state refer private entrepreneurs and individual business households as among the richest social groups (Chen 2002). The CCP's policies and legal institutions are increasingly supportive to entrepreneurship (Peng 2004). The CCP in 2002 changed its bylaws to allow entrepreneurs to become party members (Loyalka and Dammon 2006) and has welcomed entrepreneurs in the inner circle and upper echelons of the party (Pomfret 2001; The Economist 2003). In a 2001 speech during celebration of the party's 80th anniversary, then President Jiang Zemin acknowledged the benefit that capitalists bring to the economy (Hoogewerf 2002). He also handed party membership to the founder of one of China's most respected companies and the first private company to list on a foreign stock exchange (Pomfret 2001). In another case, in 2003, the CCP appointed Yin Mingshan, one of China's wealthiest private entrepreneurs, as deputy chairman of an advisory body to the government of Chongqing municipality. He was the first private businessman to be awarded such a high position (The Economist 2003). Although some analysts argue that the seemingly impressive position carried "no real power", optimists argue that these entrepreneurs will give the private sector a more powerful voice in policymaking (The Economist 2003) and weaken forces contributing to regressive changes in institutions influencing private entrepreneurship. Based on above discussion, the following is presented:

*P<sub>2</sub>: A shift in the government's basis of legitimacy from MarxLeninism to economic legitimacy shifts political entrepreneurship and collective entrepreneurship to market entrepreneurship.*

### **Normative institutions and entrepreneurship in PS economies**

Normative components introduce "a prescriptive, evaluative, and obligatory dimension into social life" (Scott 1995, p. 37). Practices that are consistent with and take into account different assumptions and value systems are likely to be successful (Schneider 1999). Elements of normative institutions also include trade associations or professional associations that can use social obligation as a tool to induce certain behavior. Normative institutions are concerned with procedural legitimacy and require entrepreneurs to embrace socially accepted norms and behaviors (Selznick 1984). The basis of compliance in this case is related to social and professional obligations and non-compliance can result in societal and professional sanctions (Grewal and Dharwadkar

2002).

The battle to promote market entrepreneurship is about more than just creating market friendly political and economic institutions. In this regard, it is important to note that one of the important ruins of socialism is a negative social perception of entrepreneurs and market entrepreneurship. For instance, in the early years of China's reform, most private entrepreneurs and business owners (*getihu*) consisted of unemployed people, workers dismissed or retired from their jobs, ex-criminals, and those with problematic political histories (Davis 1999; Gold 1990; Li 1993; Ma and Parish 2006). These entrepreneurs were thus perceived to be "social outcasts" and in the 1980s and the early 1990s faced considerable social discrimination and stigma (Tsai 2006). Overcoming the institutional inertia (White 1992) has been a major problem and social approval of private entrepreneurs remains problematic (Ma and Parish 2006).

In PS economies, there is an "apparent hostility" to entrepreneurship and profit making at the social level (Kalantaridis 2000). The word "private", for instance, is a sensitive term in China (Richter 2000). Note that under the "market track" of the Chinese "dual-track approach", economic agents were allowed to participate in the market but they were required to fulfill social obligations (Lau et al. 2001). As a sign of reminiscent of socialist era, some still consider entrepreneurs as members of the working class striving for the country's development providing benefits to the society (Mourdoukoutas 2004). In an ethnographic study, Hsu (2006) found some entrepreneurs were understood as "cadres" and were judged by their ability to provide socialist benefits. Faced with such societal perceptions, some Chinese entrepreneurs are sensitive to the society and the CCP that resist ideas related to the ownership of private property (The Economist 2006). Accumulating a huge amount of wealth is thus a "delicate subject" in China (Hoogewerf 2002). Some still consider entrepreneurs as "selfish, avaricious peddlers", or "getihu" (Hsu 2006). In sum, we argue that:

*P<sub>3</sub>: Because of institutional inertia, normative institutions in PS economies are less supportive of free-market entrepreneurship than in matured market economies.*

### **Cognitive institutions and entrepreneurship in PS economies**

Although all components of institutions are intertwined with culture (Neale 1994, p. 404), cognitive institutions are arguably most closely associated with culture (Jepperson 1991). These institutions represent culturally supported habits that influence entrepreneurship. In most cases, they are associated with cognitive legitimacy concerns that are based on subconsciously accepted rules and customs as well as taken-for-granted cultural account related to entrepreneurship (Berger and Luckmann 1967). Scott (1995, p. 40) suggests that "cognitive elements constitute the nature of reality and the frames through which meaning is made". Although carried by individuals, cognitive programs are elements of the social environment (Berger and Luckman 1967).

To put things in context, the cognitive dimension of entrepreneurship is related to the lens through which entrepreneurs view different ingredients of entrepreneurship (Mitchell et al. 2002, p. 96). Cognitive institutions are crucial in the explanation of why and how of the existence and growth of entrepreneurial firms (Witt 2007). With respect to the cognitive institutions, it is argued that entrepreneurs in PS economies tend to have a lower level of entrepreneurial skills than in mature market economies (Smallbone and Welter 2006). The majority of managers who are still running most Russian enterprises have values from the Soviet period, as well as values passed on from the previous tsarist era (Taylor and Kazakov 1997).

Experience and training gained under the communist system contributes very little for the management and business skills needed for free-market entrepreneurship (Lyles et al. 2004; Warner and Daugherty 2004). This is powerfully illustrated in many Chinese entrepreneurs' lack of understanding of practical distinctions between various types of financing (Kambil et al. 2006) and "soft" concepts of management such as marketing and consumer behavior (Borgonjon and Vanhonacker 1992). Beyond all that many Chinese managers' cognitive framework reflects a "government takes care of everything" culture (Lynch 2005).

Likewise, prior research indicates that Russian entrepreneurs' failure can be attributed to their lack of

management and business skills needed for free-market entrepreneurship (Babaeva and Lapina 1997, pp. 27–28; Holtmann 1997, p. 8; Kihlgren 2003). For instance, Russian managers with experience in state-owned enterprises tend to follow practices from their past. Overcoming institutional inertia such as those related to a lack of accountability, initiative, and trust to others has been a problem (Taylor and Kazakov 1997). In general, in Eastern Europe, while there is no dearth of technology talent, management skills have been in a short supply (Edmondson and Schenker 2007). It is important to note that traditionally, a central plan rather than the consumer was the driving force of national production in these economies (Borgonjon and Vanhonacker 1992). Concepts related to marketing and management were perceived by the Communist regimes a threat to their ideology (Borgonjon and Vanhonacker 1992).

A second way in which cognitive institutions affect entrepreneurship in PS economies concerns the psychology of risk taking. The lack of a tradition of private entrepreneurship is also related to an underdeveloped risk-taking culture in the absence of local norms and social networks providing support for such a culture (Warner and Daugherty 2004). For instance, Russian managers with experience in state-owned enterprises tend to avoid risk (Taylor and Kazakov 1997). Similarly, the Chinese VC landscape discourages risk taking. Most VC funds in the country are linked to the government and can be considered as a loan (Harwit 2002). Enterprises that are able to obtain VC funds feel an obligation not to lose the resources. Moreover, an incubator losing the government owned money also becomes a target of official criticism. Chinese government VC funds thus cannot accept the Western level of risk taking (Harwit 2002). The above leads to the following conjecture:

*P<sub>4</sub>: Because of institutional inertia, cognitive institutions in PS economies are less supportive of free-market entrepreneurship than in matured market economies.*

## **Discussion and implications**

The framework proposed in this paper offers incremental value to the literature on demand side of entrepreneurship. We integrated streams of literatures from economics, law, management, sociology, political science, and international affairs to develop a framework on entrepreneurship in PS economies. This is both the paper's limitation and as well as contribution. While the four propositions suggested above may not themselves represent theory (Sutton and Staw 1995), we have provided reasoning and justification for each proposition which is the crucial part of the theory development process (Webster and Watson 2002).

It is important, in this context, to look at the connection between formal and informal institutions from the standpoint of entrepreneurship. It is worth noting that an institutional pillar both reflects as well as determines the nature of the other pillars (Hayek 1979). North (1994) observes that informal rules provide legitimacy to formal rules. Likewise, Axelrod (1997) notes: "Social norms and laws are often mutually supporting. This is true because social norms can become formalized into laws and because laws provide external validation of norms" (p. 61). This implies that an institutional pillar's change in favor of market entrepreneurship is likely to trigger other pillars' changes in the same direction. To put things in context, entrepreneurship-friendly laws and regulations (e.g., bylaws to allow entrepreneurs to become a CCP member in China) may erode the hostility to entrepreneurship and profit making at the societal level. Likewise, with the development of skills and expertise needed for free-market entrepreneurship, psychology of risk taking, and social networks to provide support for entrepreneurship, the governments are likely to face pressures to enact new laws and regulations.

In most cases, compared to formal institutions, de-institutionalization and re-institutionalization of social practices, cultural values and beliefs occur very slowly (Clark and Soulsby 1999; Ibrahim and Galt 2002, p. 109; North 1990; Zweynert and Goldschmidt 2006). North (1990, p. 6) noted that "although formal rules may change overnight as the result of political and judicial decisions, informal constraints embodied in customs, traditions, and codes of conduct are much more impervious to deliberate policies". From the standpoint of the development of free-market entrepreneurship in PS economies, the real issue thus concerns overcoming institutional inertia related to informal institutions.

We noted above that PS economies vary in terms of the development of free-market entrepreneurship.

Institutions to support private enterprises such as protection of property rights have not developed at the same rate across PS economies (Johnson et al. 2002). The concepts of “the holistic order” and “the extended, functionally differentiated order” (for review, see Zweynert and Goldschmidt 2006) may be helpful to explain the variation. A holistic society is often characterized by an ideology, mostly in the form of a religion, that “claims validity for all spheres of action and thought” and an action’s legitimacy is evaluated on the basis of a “general binding moral prescripts imposed by a superior authority” rather than by economic, political, or juridical logics (Zweynert and Goldschmidt 2006). In some cases, the ideology concerns the value system (e.g., Asian Values for China; Chang et al. 2006). The heterogeneity in CEE economies can arguably be explained in terms of the degree of religious-secular differentiation. Historically, compared to the Latin group (Croatia, Czech Republic, Estonia, Hungary, Lithuania, Poland, Slovakia), Orthodox countries (Belarus, Bulgaria, Romania, Russia, Ukraine) lacked the religious secular differentiation (Pipes [1971] 1992; Buss 2003). It is suggested that the “political capitalism” thesis holds more clearly for the PS Orthodox economies compared to Latin ones (Eyal et al. 1998). In the Orthodox countries, which are closer to the holistic end in the holistic extended continuum, informal institutions did not change at the same rate as formal institutions (Warner and Daugherty 2004). The Orthodox tradition viewed entrepreneurship negatively (Gerschenkron 1954) and socialism further reinforced the stereotypes (Kuznetsova 1999; Kalantaridis 2007). The development of entrepreneurship-friendly institutions is likely to be slower in the Orthodox group than in the Latin group. Evidence of profound change in the entrepreneurial landscape is more readily apparent in the latter compared to the former group. For instance, Hungary closely follows international accounting standards (Wright et al. 1999) while Russian companies widely practice double accounting (Brovkin 2001).

A related point is that the two groups of economies differed drastically in terms of the entrepreneurial tradition during the communism and pre-communism era. For instance, compared with the Czech Republic, Poland, and Hungary, the state was the principal entrepreneur in Russia and private entrepreneurship arguably had a weak tradition even before the revolution (Kihlgren 2003). Moreover, during the communism era, while some form of private entrepreneurship was allowed in Hungary and Poland, Russia and Romania entirely depended on the central planning (Kihlgren 2003; Stoica 2004). A similar point can be made about political entrepreneurship. Political entrepreneurship is likely to be more manifest in the Orthodox group than in the Latin group. Likewise, thanks to the institutional inertia associated with collective entrepreneurship, political entrepreneurship is more latent in China than in most CEE economies.

Society’s perception of entrepreneurial activities may differ across types of ventures. For instance, in China, from the social standpoint, the road to entrepreneurship is beginning to look like a little smoother. Especially, educated entrepreneurs running high-tech businesses are respected and viewed as good businesspeople (Hsu 2006). There is thus the deinstitutionalization of the logic (Scott 2001) that entrepreneurs need to fulfill social obligations.

One final, but not less important, aspect of informal institutions in PS economies that renders it interesting to us is the fact entrepreneurs can take measures to change them in favor of private entrepreneurship. Indeed, negative social perception of profit making behavior is not a phenomenon observed only in post-socialist economies. In Sweden, for instance, the think tank, Timbro is working to bring a long-term shift in the “public opinion in favor of free-markets, entrepreneurship, private property, and an open society” (Lehrer and Hildreth 2002). The institute is funded mostly by large Swedish corporations. PS economies can borrow a page from Timbro’s lesson book.

There obviously is a need for more research on entrepreneurship in PS economies. One extension of the present work is to investigate a more complex model by adding additional dimensions. For instance, cultural factors (e.g., collectivism vs. individualism) may have strong influence on a PS economy’s trajectory to market economy. Many international studies on entrepreneurship have focused on culture (Busenitz et al. 2000) and a number of them have linked Hofstede’s (1980) cultural dimensions—especially individualism—to examine a country’s propensity to engage in entrepreneurial activities. In this regard, our work also opens new areas of research in terms of how culture interacts with other dimensions of institutions in PS economies from the

standpoint of free-market entrepreneurship.

One issue that was raised above but not fully developed was the functioning of institutional entrepreneurship. Future research on this topic should help us better understand the phenomenon of institutional entrepreneurship that has become pervasive in PS economies, and perhaps to find better ways of managing this form of entrepreneurship, both from the viewpoints of institutional entrepreneurs and the government.

Researchers could also examine how certain forms of entrepreneurs that are found both in PS and matured market economies differ in the two groups of countries. Social entrepreneurship would be one such form of entrepreneurship. There are reasons to believe that institutional pressures faced by social entrepreneurs — individuals or private organizations, whose entrepreneurial ventures address social problems (Korosec and Berman 2006; Wong and Tang 2006, p. 627)—may differ in the two groups of economies.

### Notes:

1 See: [www.policy.hu/szilagyi/respaper.htm](http://www.policy.hu/szilagyi/respaper.htm).

2 See: “Commission targets undeclared work”, [www.eiro.eurofound.eu.int/1998/04/feature/eu9804197f.html](http://www.eiro.eurofound.eu.int/1998/04/feature/eu9804197f.html).

3 We thank an anonymous JIEN reviewer for suggesting this.

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