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UNDERSTANDING INSTITUTIONS IN THE CONTEXT OF ENTRE-PRENEURSHIP

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Abstracts
Purpose- *Entrepreneurs propose; institutions facilitate; markets decide; knowledge grows and development occurs. This process of development with growth of knowledge through institutions and entrepreneurship may be of interest for many. But the topic 'Institutions and Entrepreneurship' overlaps several areas of research, and therefore works are fragmented.*

Design/methodology/approach- *The paper pulls together these various strains of research. Various theoretical and empirical studies have been discussed related to this but are of course not exhaustive.*

Findings- *The contributions of both the classical and modern literatures are equally important in understanding the two related and valuable concepts of Institutions and Entrepreneurship. Identifying the variables through which the mechanism of Institutions affect the quantity and quality of Entrepreneurship of a region are crucial. The paper advocates the study of Institutions in a cluster; in a general framework rather than in isolation. The efficiency of an institutional set up hinges on the various complementary elements and therefore there is a need of coherence among all related variables to deliver a unified and mutually reinforcing environment.*

Research paper

Keywords: *Institutions, Context, Entrepreneurship*

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Introduction

Many eminent scholars have considered entrepreneurship crucial for economic prosperity of a region. It is considered an important mechanism for economic development through employment, innovation and welfare. Entrepreneurship is so important for economic performances that it has sometimes been conceptualised as fourth factor of production besides land, labour and capital. It is considered as the 'missing link' between investment in knowledge and economic growth. Moreover policymakers want to encourage entrepreneurship in their local economies because of its linkage to stronger subsequent job growth for regions. Studies on entrepreneurs or entrepreneurship have extensively discussed on personal traits of recognised entrepreneurs based on the ideas of (Cantillion, Schumpeter, Mises, Kirzner, Knight) and have highlighted the individual attributes and capabilities centred on the individual units. However scholars have also paid attention to the environment that defines and creates opportunities for them. This environmental view in which the concept and practice of entrepreneurship is enshrined with virtuous status has been considered as a potent act of institutionalisation by Hwang and Powell (2008). The institutional environment view of entrepreneurship argues that while entrepreneurship is important in all economies, its supply and performances depend on the external environment (Institutions). Various studies (Braunerhjelm and Henrekson, 2013; Boettke & Coyne, 2009; Acs & Szerb, 2010; Estrin and Mickiewicz, 2010; Dinh, Mavridis and Nguyen, 2010; Acemoglu and Johnson, 2005; Sautet, 2005; Rodrik, Subramanian and Trebbi, 2004, Harper, 2003; Hall and Soskice, 2001 and many others) have advocated the importance of Institutions in the field of entrepreneurship. The structure and level of institu-

tional set up may have a major influence on quality as well as on the quantity of entrepreneurship. An adequate institutional framework may enable a region to be capable enough of catching any innovation anywhere rather than engaging in hefty competition. Therefore the relationship of institutions and entrepreneurship is important to understand why the relative contribution of entrepreneurship varies significantly across the regions.

Entrepreneurs propose; institutions facilitate; markets decide; knowledge grows and development occurs. This process of development with growth of knowledge through institutions and entrepreneurship may be of interest for many policymakers. There may be a room for them to build up a favourable environment which can attract the innovators and knowledge bearers. The variations in entrepreneurship level between regions can be better understood through the lens of institutions. But from an empirical perspective and policy view point it is also necessary to find out which Institutional variables or regional traits encourage local entrepreneurship of a region? Because the topic 'Institutions and Entrepreneurship' overlaps several areas of research, works are fragmented. The purpose of the paper is to pull together these various strains of research to illustrate the fundamental and current state of knowledge on Institutions and entrepreneurship. For the purpose of the paper various theoretical and empirical studies have been discussed, but are of course not exhaustive. It hopes to contribute in understanding these two related and valuable concepts. This section of introduction is followed by section 2 in which the definitions, concepts and importance of entrepreneurship are discussed. Section 3 discuses the concepts and significance of Institutions in general and specific to entrepreneurship. In section 4 various empirical literatures related to institutional variables *and determinants are illustrated. Section 5 concludes with policy implications.*

Entrepreneurship: Definitions and Importance

Definitions

The concept of entrepreneurship would be always there in the society but the term "entrepreneur" first appears in the literature in 1253, when it was used in different forms (e.g. 'empreneur') and after that it was commonly used in 1500 and 1600s (Filion, 2011). Richard Cantillion in his famous work 'Essay on the Nature of Commerce in General (1755)' described the entrepreneur as a person who purchases a raw material at a known price and sell it at unknown price (as cited in Filion, 2011). From the definition of Cantillion we can extract at least two dimensions of entrepreneurship, first the investment by purchasing raw material and second the risk of selling at unknown price. After Cantillion, Jean-Baptiste Say regarded entrepreneurs as being people who could do new things, people who could do more with less, and people who would obtain more by doing something in a new or different way (as cited in Filion, 2011). The pioneer of the entrepreneurship, Schumpeter coined the word 'unternehmergeist' German for entrepreneurial spirit acknowledging "fiery souls" or "wild spirits". He believed that entrepreneurs are the individuals who make ideas workable in the economy and can challenge the established ways of doing things. Schumpeter in his classic treatise 'Theorie der wirtschaftlichen Entwicklungen (Theory of economic development, 1911)' mentioned the concept of "creative destruction" related to the contribution of innovation by entrepreneurs (Audretsch, Keilbach and Lehman, 2006; Ripsas, 1998; Filion, 2011). He *described five types of innovative activities by entrepreneurs as the entrepreneurial function involving the (a) New Products, (b) New Methods of Production, (c) New Sources of Supply, (d) New Markets and (e) New Ways to Organise (Hwang and Powell, 2008). For Schumpeter an entrepreneur need not to be an inventor, he can innovate even within the available conditions by recombination. He argues that the inventor produces ideas, but the entrepreneur "gets thing done" (as cited in Godin, Clemens and Veldhuis, 2008). Similar to Schumpeter's view Kirzner, a representative of Austrian tradition described the entrepreneurs as 'alert discoverer' or discoverer of new opportunities; who unlike all other participants are not mere price takers but are capable of price and quality making. "The entrepreneur who dominated my 1973 work did not need to be creative at all; He simply had to be alert to price differentials which others had not yet noticed " (Kirzner, 2008). According to Kirzner an entrepreneur is an arbitrageur; a middleman who recombines productive activities to produce more valuable outputs and/or use cheaper inputs in order to squeeze out those arbitrage-profit opportunities which he has noticed as an alert discoverer (Kirzner, 2008; Rippas, 1998; Fogel, Hawk, Morck and Yeung, 2008). Thus profit winning behaviour of entrepreneurs is a creativity that embraces alertness too. Following Mises and Hayek, Kirzner (1997) has also highlighted the decision making capacity of entrepreneurs and their perception of profit opportunities as market-imbalance equilibrating function. The concept of uncertainty and the entrepreneur as the risk bearer became the focus of Knight and Chicago school in the field of entrepreneurship. Even Schumpeter notes that the capitalist function and entrepreneurial function often overlap in reality, and thus entrepreneurs often become bearer of risk in their role as capital-*

ist. Adaptive and speculative functions of entrepreneurs are highlighted by Von Mises, Schumpeter, Knight and many others (Godin, Clemens and Veldhuis, 2008; Kirzner, 2008). Casson (1982) made an addition by stressing the role of entrepreneur as co-ordinator who tries to integrate entrepreneurial decisions making (as cited in Ripsas, 1998). Leibenstein (1968) defines entrepreneur as an individual or group of individuals with four major characteristics: he connects different markets, he is capable of making up for market deficiencies (gap-filling), he is an "input completer" and he creates or expands time binding, input-transforming entities (i.e. firms). Combining many of these definitions Filion (2011) expresses: an entrepreneur is an actor who innovates by recognising opportunities; he or she makes moderately risky decisions that leads into actions requiring the efficient use of resources and contributing an added value. While there are many definitions available for entrepreneurs, Baumol's notion regarding entrepreneurship are that the subject is conceptually elusive and term has not always had clear theoretical content (Leff, 1979). Therefore defining entrepreneurship is difficult and lack agreements among economists as it has various dimensions. That would be a probable reason that the term entrepreneur and entrepreneurship is used interchangeably in the literatures and one may find many definitions of entrepreneurship depending on the context of studies of various authors. While a generally accepted definition is lacking there is agreement that the concept comprises numerous dimensions like unique traits, risk taking, opportunity recognition, coordination, recombination, motivation and exploitation and innovation. All the aspects whether Schumpeterian creativity, Kirzner's alertness and arbitrage contexts or Knight's uncertainty-bearing are part of entrepreneurial activity. Lazear (2005) *makes a statement in relevance that entrepreneurs perform many functions and therefore must be a generalist "Jacks of all Trades" who need not excel in any one skill. He describes entrepreneurship as the process of assembling necessary factors of production consisting of human, physical and information resources and doing so in an efficient manner. All the attributes of entrepreneurs' and the activities pursued by him may be considered as entrepreneurship. Entrepreneurship and entrepreneurs cannot be dissociated from each other.*

Importance of Entrepreneurship

Traditionally economists stress on increasing productivity to overcome the problem of diminishing returns. Initially it was supposed to be achieved through accumulation of physical capital and division of labour by specialisation. Later new growth theorists like Romer and Lucas have recognised knowledge as an essential driver of economic growth. The mandate for entrepreneurship policy has emerged from the failure of the traditional policy, corresponding to the Solow model or those based on instruments promoting investment in physical capital and from the failure of the new policy instruments, corresponding to the Romer model or those promoting investment into knowledge capital through education and research and development (Audretsch et al., 2006). For the advocates of entrepreneurship the source of productivity enhancement lies in the increase of knowledge which entrepreneurial activity generates and exploits the same for profit and growth. Though there was direct production of knowledge or important inventions made in some economies, there was little effort to imitating and implementing the ideas (Schmitz, 1989). For example early china and Sweden are believed to have such experiences. Sweden and many other European coun-

tries with high level of investment in research and development and human capital had stagnant growth rates and were sluggish throughout the 1990s and into the new century (Audretsch et al., 2006). This empirical experience of failure of investment in new knowledge has recognised entrepreneurship and/or small firms essential for economic growth. Entrepreneurship takes on adequate importance in today's knowledge economy because it serves as a key mechanism by which ideas or knowledge are transformed into the action contributing to economic growth and employment. Audretsch et al. (2006) have recognised it as the 'missing link' between investment in new knowledge and economic growth. Moreover they advocate that rather than imposing efficiency burden on the economy as seemingly was the case in the Solow economy, entrepreneurship serves as an engine of growth by providing a vital conduit for the spill over and commercialisation of knowledge and new ideas. Even the Schumpeter's metaphor of "creative destruction" is embedded in the basic process of entrepreneurship fuelling economic growth. In case of developing countries Leff (1979) considers entrepreneurship essential for investment, innovation and structural changes if economic development is to be achieved in the underdeveloped countries. He identifies a key function of entrepreneurship in developing countries is to mobilise factors such as capital and specialised labour which are imperfectly marketed. Therefore entrepreneurship also acts as a channel for inputs supply and sale of outputs in the process of economic development. It has come to be well recognised now that an economy's prosperity depends greatly on a dynamic entrepreneurship sector and the difference of entrepreneurial opportunities and activities is one important factor determining the varying *levels of wealth and prosperity across regions and countries (GEM, 2011; Boettke & Coyne, 2009).*

Institutions: Meaning and Significance

Meaning of Institutions

'Agent-Structure' mechanism would be the basis of the concept of Institutions and being a conceptual term there may be various conceptions and definitions of it. The notion of Institutions can be traced back to the Adam Smith (1776) who put forth the famous notion of the "invisible hand" which operates within the market context (as cited in Boettke and Coyne, 2009). Formal and informal Institutions would be the Smith's 'invisible hand' which takes care of the market as an Institution coordinated by the pricing system. But prior to 1918, Institutional Economics had not emerged as an identifiable school of economic thought. Yet by that time, Thorstein Veblen's works had achieved an immense popularity (Hodgson, 2004). Thorstein Bunde Veblen (1857-1929) is believed to be a primary mentor, along with John R. Commons of the Institutional Economics movement. He wanted economists to grasp the effects of social and cultural factors on economic outcomes. Veblen famously described Institutions as involving 'settled habits of thought, common to the generality of men and being an outgrowth of habit' (Hodgson, 1998; 2004). Commons identified them as collective action in control of individual action (Mitchell, 1935). The other promoters of Institutionalism were Hamilton, Clark and Mitchell. Hamilton (1932) saw an Institution as "a way of thought or action of some prevalence and permanence which is embedded in the habits of a group or customs of the people" (as cited in Hodgson, 2004). While Veblen and Hamilton stress on the settled habits and thoughts, Mitchell developed the Institutional economics of

aggregates and hinted the idea of 'Downward Causation' from Institutions to individuals. The views of these economists with core ideas of habits, way of thought, downward causation, and Institutions and their evolution are referred as 'Old Institutional Economics (OIE)' in the literature of economics. OIE had some objections with the mainstream economics and had an alternative view. For Hamilton the most important omission of neoclassical economics theory was its neglect of "the influence exercised over conduct by the scheme of institutions under which one lives" (as cited in Hodgson, 2004). Similarly Mitchell argued that economics had been misled into an abstract description of rational economic man. The real problem of economics was to understand the Institutional and cultural context in which individual capabilities were moulded. Clark also undermined the proposition of global rationality by showing that, because of imperfect information even if the rational calculator had reached an optimum 'no claim of exactness' could be made (Hodgson, 2004). But the idea of old Institutionalism in particular was partially disabled by a combined result of the profound shifts in social sciences in 1910-1940 period and of the rise of a mathematical style of neoclassical economics in the depression stricken 1930s (Hodgson, 1998). During this period, Coase and his works are also sometimes believed to belong to the tradition of institutionalism. It is commonly said and it may be true that the New Institutional Economics start with Coase's article "The Nature of the firm (1937)" with its explicit introduction of transaction costs into economic analysis (Coase, 1998). [North][1] points that it was Ronald Coase who made the connections between the institutions, transaction costs

[1] An Essay by Douglass C. North, Washington University, St. Louis available at: http://128.118.178.162/eps/eh/papers/9309/9309002.pdf (accessed March 15, 2014).

and neoclassical theory: a connection which even now has not been completely understood by the economic profession. After some decades from the mid-1970s, the New Institutional Economics (NIE) began to attract the attention within the discipline of economics. In 1975, Oliver E. Williamson published his ground breaking work, 'Markets and Hierarchies' and called his approach New Institutional Economics (Groenwegen, Spithover and Berg, 2010). Williamson did not want to be associated with OIE and considers his NIE not to be an alternative but complementary to neoclassical economics. According to North the NIE builds on, modifies and extends neoclassical theory to permit it to come to grips and deal with an entire range of issues heretofore beyond its ken [North]. Basically NIE is an attempt to incorporate institutions into economics. The ideas of NIE have received widespread recognition when Douglass North has been awarded Nobel Prize for his work on Institutions and Institutional change. Perhaps he has provided the most commonly agreed definition: "Institutions are the humanly devised constraints that structure political, economic and social interaction. They consist of both informal constraints (sanctions, taboos, customs, traditions and codes of conduct) and formal rules (constitutions, laws, property rights)" (North, 1991). After some modifications North redefined Institutions in the following terms: 'Institutions are the constraints that human beings impose on human interaction' (as cited in Hodgson, 2004). He wrote most often of formal and informal constraints rather than formal or informal rules to overcome the misconception that all Institutions are decreed in laws or rules. The definition of North suggests three fundamental elements of Institutions: the first one is the formal or written constraints-political systems, laws, governing contracts, the imposition of taxes, tariffs *and regulations etc. These constraints can be created by governments as well as within firms and organizations. The second one is the informal constraints, written in the minds and hearts of people-culture, norms of behaviour, customs, values and religions etc. The last one is the enforcement mechanism. Institutions have no meaning without practice or enforcement. Enforcement means not only enforcement of agreements but also protection of lives, goods and services (North, 1991). The recognition of social and exogenous influences on individual cognition places North very close to or even within the old institutionalism's tradition view of* downward causation. *The basic idea of Institutions (formal and/or informal) is the aggregate structure having influence on the individual units which develops a particular behaviour on them.*

***Figure 1**. The Institutionalist Action-Information Loop*

Source: Hodgson, 1998

Individuals act according to the information and thoughts they have acquired from Institutions. Institutions provide guidelines to them by constraining and/or enabling their activities. On the other side, the structure of Institutions is determined by the interactions of the individual agents. It is not only the given structure which influence actors, these actors preferably *the 'innovators' also change the structure. Institutions are not under individual control but the individual actions of several actors which are under their control lead to the evolution of Institutions (Hall and Soskice, 2001). Individual interactions and their learning through repeated experiences may bring changes. Learning results new habits of life and thought; thus brings changes in Institutions (Henrekson and Sanandaji, 2011).There are subsequent and continuous changes of Institutions through individual and/or entrepreneurial feedback. Based on this whole 'Agent-Structure' mechanism Clauge et al. in 1997 have mentioned five branches existing within the NIE: Transaction Cost Economics, The Economics of Property Rights, The Economics of Imperfect Information, Collective Action Theory and The Evolution of Rules and Norms (Boliyari & Topyan, 2007). Thus Institutions may be conceptualised as something exogenous in terms of influence on individuals and endogenous in the form of individual habits and thoughts implied and their evolution by social and economic interactions.*

3.2 Significance of Institutions

Throughout history, Institutions have been devised by human beings to create order and reduce uncertainty in exchange (Dugger, 1995). Therefore Institutions are believed to bring order to an otherwise chaotic world. Because of its downward causation mechanism Institutions have always been considered to be a critical ingredient in understanding the wealth of nations. Smith (1776): The different talents and dispositions we possess do not stem so much from nature but from "habits, customs and education" (as cited in Boettke & Coyne, 2009). Veblen had a valid and enduring insight regarding Institutions that an understanding of the roles of both instinct and habit is essential. His clearest statement was that Institutions function as *repositories of social knowledge and it may directly affect our choices by providing incentives, sanctions or constraints (Hodgson, 2004). One of the primary exponents of the 'Primacy of Institutions' Rodrik (2000) makes a relevant statement that Institutions govern and shape the interactions of human beings, by helping them to form expectation of what other people will do. Institutional set up provide guidance regarding what actions are allowed or constrained, who is eligible to make decisions, what procedures should be followed and what payoffs are available. Institutions influence behaviour and are meant to provide certain safeguards before we enter into transactions (Groenwegen et al., 2010). They are believed to constrain and enable the social and economic interaction. The constraining function of Institutions can be explained as limiting the agents whether super-rational or sluggish to stay on one side of the line. Exploring it further Gode and Sunder suggest that structural constraints can produce similar outcomes, whatever the objectives or behaviour) have identified "Institutions" as primary causes of reversal of income and prosperity around the world. It is the emergence and diffusion of a novel set of Institutions most often extractive institutions which made the dramatic reversal of fortune in the countries like India and Indonesia, which were once prosperous to one which is now among one of the poor economies of the world. The institutional differences across the regions can be one important element to explain their economic performances. The concept of 'costs of exchange' highlighted by Coase depend on Institutions of a country: its legal system, its political system, its social system, its educational system, its culture and so on (Coase, 1998). The institutional approach/model's prediction is that two locations with identical geographical features, demographics, and the same level of inputs* *(or resources) can have different outcomes because of different institutional structures (Hall and Sobel, 2008). In relevance to differences of Institutions and their influence on economic performances, Hall and Soskice (2001) introduce the concept of Comparative Institutional Advantage. The concept of scarcity applies to natural resources in absolute sense but is relevant to Institutions only in the relative sense, concerning immediate and easy availability of resources for an agent. Constraints such as trust, secure property rights, information, skill and education differ across the societies but can sometimes be enhanced; therefore they are not scarce in absolute sense rather in relative sense. Romer (1998) has made an important comment that we must not presume that devoting more resources to the basic research end of the process will automatically lead to economic gains. Businesses and places that provide good environment are just as important as conducting research (as cited in Cortright, 2001). Glaeser, Scheinkman and Schleifer (2003) advocate Institutional reform more important than redistribution for economic development.*

Role of Institutions in Entrepreneurship

The simple notion of presence or absence of entrepreneurship culture in any particular society and among its people has some challenging views today. The conception that undersupply of entrepreneurship in a society is due to natural lack of entrepreneurial culture among its members does not seem true. Human minds are amongst other things creative and enterprising, when provided with opportunities and incentives the basic instincts of human is to develop better ways of doing things (Potts, 2003). Sautet (2005) makes a relevant claim that entrepreneurial activity is never in short supply and is not dependent on culture or race, it can be observed in every society *and across all ethnicities. Ultimately what matters is the reality of the incentives that people experience. Institutions are critical determinants of economic behaviour and economic transactions in general. They can impose direct and indirect effects on both the supply and demand of entrepreneurs (Acs & Szerb, 2010). Entrepreneurship cannot take place in vacuum; it depends on Institutions for performances because entrepreneurial activities are not self-performing, self-regulating and self-stabilising. Institutions provide incentives as well as constrain the opportunities available at any point of time according to which entrepreneurs flourish, shrink or vanish. Opportunity recognition is at the heart of the entrepreneurship and therefore the attention should be towards the wider environment that both defines and create opportunities. Entrepreneurial opportunities and activities differ significantly across societies. These differences in entrepreneurial opportunities and activities are not due purely to differences in entrepreneurial spirit, but instead are due to differences in Institutions (Boettke & Coyne, 2009). The importance of Institutions implies that due to the existence and downward causation of Institutions, individuals behave differently in the presence of different Institutions. Leibenstein (1968) expresses that entrepreneurship may be scarce in some economies but some entrepreneurial characteristics may in fact be in surplus supply; that is they are unused simply because of lack of motivational state and slight favourable changes in Institutions may turn entrepreneurial scarcity into an abundant supply. Therefore Mcmillan and Woodruff (2002) proposes that to explain the low levels of entrepreneurship, we first point to the weakness of Institutions such as property rights enforcement (as cited in Estrin and Mickiewicz, 2010). Even a strong and persistent entrepreneurial culture does not guarantee* *successful entrepreneurship. Several favourable conditions are required besides incentives and property rights. Only under a certain Institutional context entrepreneurs have incentive to discover and enhance knowledge. Rodrik (2000) makes a statement that it has become clear that incentives would not work or generate perverse results in the absence of adequate institutions. For example if government policy of subsidies or other such policy initiatives are directed towards increasing entrepreneurship through maximising the number of start-ups, this may stimulate individuals to start businesses for the wrong reasons. There is a probability of starting businesses not because they have idea or skill that they want to try and commercialise, but simply because they have an access to money for starting a business. These firms or businesses are likely to be unsuccessful in the lack of other complementary Institutions. They may even shut down once the scheme is removed. Dinh, Mavridis and Nguyen (2010) recognise that low quality institutional framework (financial constraints specifically) hampers the development of small firms to grow into medium sized or large firms, causing the "missing middle" phenomenon in developing countries. Therefore first Institutions should be strengthened and made favourable for the entrepreneurs to make them productive and successful. Hall and Sobel (2008) argue that policymakers should focus on improving institutions, rather than trying to pursue policies to increase the quantity of inputs (subsidies for education, technology, venture capital etc.). Acemoglu and Johnson (2005) advocate that as Institutions are strengthened and the incentive structure changes, more and more entrepreneurial activities are shifted towards productive entrepreneurship. Institutions create and shape an environment for entrepreneurs to invest and innovate through which an econ-*

omy can flourish. Entrepreneurship within an appropriate Institutional framework may in effect override resource endowments and scarcity as the prime determinant of economic performance (Harper, 2003). Sautet (2005) has gone so far to state that entrepreneurship is not dependent on the resources in an economy. Rather the key is the quality of institutions that permit the exploitation of resources and opportunities. The presence and absence of adequate institutions dictate the performances of entrepreneurs and thereby the economy. The basic idea of Comparative Institutional Advantage as advocated by Hall and Soskice (2001) is that the Institutional structure of a particular economy or region provides advantages in specific type of activities there and tends to render entrepreneurs or firms less mobile even when profit opportunities are available elsewhere but with Comparative Institutional Disadvantage. The policymakers interested in promoting entrepreneurship as a means of fostering economic development may do best to focus their attention on the overarching Institutions rather than on entrepreneurship (Braunerhjelm and Henrekson, 2013).

Empirical Perspective

4.1 Institutions for Entrepreneurship

From an empirical perspective and policy view point it is not sufficient to acknowledge that Institutions do matter. It is also necessary to find out the answer for a natural policy relevant question: which Institutional variables or regional traits encourage local entrepreneurship of a region? Lin and Nugent (1995) make a relevant statement that the question before policymakers therefore is no longer "do Institutions matter?" but "which Institutions matter and how does one acquire them?" (as cited in Rodrik, 2000). To answer these questions Institutions need to be recognisable and in em-

pirical format. Policymakers need to pay careful attention on many variables and determinants which are directly or indirectly related to Institutions that structure the incentives for entrepreneurs and constrain their activities. Romer argues that everything including Institutions can always be improved (Cortright, 2001). Since Institutions relevant to various activities (including entrepreneurship) are not evenly distributed, there seems a room for policymakers to build up a favourable local environment so that entrepreneurship can flourish. The development of supporting Institutions may be crucial. It is very difficult to identify the necessary and sufficient conditions for entrepreneurship development. Moreover although some Institutions are specific, many of them are of general nature and influence every aspects of the economy (Gupta, Guo, Canever, Rokyin, Kaursraw and Lin, 2014). The efficiency of an institutional set up hinges on the various complementary elements and therefore to find an isolated one to one direct and exclusive relationship of these variables with entrepreneurship is not reasonable and may have unlimited problems. One has to study them in a cluster; in a form of Institutional framework. There is a need of coherence among all variables related to deliver a unified and mutually reinforcing environment. Informal Institutions like customs, tradition, norms and religion change very slowly; therefore NIE has been concerned principally on formal 'rules of the game (Institutional environment)' and 'play of the game (governance)' for desired outcomes (Williamson, 2000). There is no one set of Institutions that suit all societies, but there are advocacies for some supporting Institutions by development economists. The following institutional variables have a positive effect on entrepreneurial activity which are conducive for entrepreneurial development:

Property Rights

Economists have recognised secure property rights as an important Institution for economic performances. Property rights represent all the rights that have economic value. In the context of entrepreneurship we consider them of two types; first one as the property rights to private property: the right to utilise and dispose of private property at one's disposal and the second one as the property rights to contracts: the right to claim an act from another person as specified in the contract. Private property rights Institutions protect citizens against expropriation by the government as well as by powerful elites and contracting Institutions enable and/or regulate private contracts between citizens (Acemoglu & Johnson, 2005; Honorati & Mengistae, 2007). Therefore secure property rights constrain the powerful authorities and people and enforcement of contracts constrains opportunism. They also enable mostly impersonal and to some extent personal economic interactions among people. Agents need some guarantee that the decisions they take and contracts they make will be protected and they will be able to receive returns from them, if any. Systems of property rights ensure that entrepreneurs can recoup the rewards to which they are contracted (Aidis, Estrin and Mickiewicz, 2009). Otherwise the absence of secure property rights will discourage investment and innovation. Institutional economics literature has shown how important secure property rights are in encouraging investment and innovation, allowing for the investor and innovator to reap the harvest of their efforts (Bardhan, 2005). Smith (1776): "Commerce and manufacturers can seldom flourish long in any state..................in which the people do not feel themselves secure in the possession of their property" (as cited in Groenwegen et al., 2010). Rodrik (2000) also state that an en-

trepreneur would not have the incentive to accumulate and innovate unless s/he has adequate control over the return to the assets that are thereby produced or improved. Control is also important other than ownership as the people may have strong ownership but weaker control. There is also the possibility of control over the returns without ownership. Strong protection of property rights and control over the return of investment plays a pivotal role in the institutional environment conducive to entrepreneurial activity (Aidis, Estrin and Mickiewicz, 2009).

Rule of Law

Rule of law refers to the protection of persons and property against violence, theft and other such activities. Therefore it is to some extent related to the sense of protection of property rights. Usually rule of law is a perceptual concept and is enforced by governments through police, judiciary and other regulatory Institutions. Rule of law is scored higher when there is a strong court system and sound political Institutions while lower scores indicate a tradition of depending on physical force or illegal means (Knack and Keefer, 1997). In the absence of rule of law, public authorities and powerful individuals are prone to engage in a flood of arbitrary and inconsistent unproductive activities that can dampen entrepreneurship and economic growth. Harper (2003) advocates that rule of law allow entrepreneurs to make the best use of their own unique competencies and localised knowledge. It stipulates that law must be enforced; violations if any should be adjudicated by an independent judiciary. Judiciary and police have an important role in creating faith in law. The fundamental underpinnings of Institutions are an effective legal structure and court system to enforce contracts and laws (North, 1991). Inefficient judicial process may cause more viola-

tions of property rights, breach of trust and violence. Fogel et al. (2008) argue that weak property rights and lack of faith in the courts discourages investment even though opportunities exist. Weak judiciary imposes significant costs on doing business more specifically in developing countries (Rodrik, 2008). Individual perception about the fairness and justice is quite essential as it obviously affect the decisions regarding investment. Rule of law along with secure property rights improve the transactional trust and make coordination failure less likely which is important for entrepreneurship development.

Besides the Institutions of property rights and rule of law there are some context specific variables of entrepreneurship, of course not in strict sense. These variables may be termed as Institutional prerequisites or determinants of Institutions and are from supply side conditions which promote or constrain the generation and application of entrepreneurship.

Market Size

Acs and Szerb (2010) have explained the size of market as a combined measure of domestic market size in terms of GDP or income and the urbanisation of a region. Both of them are used jointly to measure the agglomeration effect on the opportunity perception of entrepreneurs. The interaction of higher per capita income and urbanisation create new market niches and provide more opportunities for entrepreneurs. Development level which is sometimes measured in the terms of per capita GDP/Income operates on Institutional quality through both supply and demand. It provides resources for better Institution formation and also demands a better Institutional quality. Positive relationship between growth and Institutions has been advocated in many studies (Rodrik, 2004; Alonso & Garcimartin, 2009; Acs &

Szerb, 2010). On the other hand low purchasing power has been identified as formal Institutional barrier for entrepreneurship development by Aidis (2005). In the Mills and Schumann model high level of output can be interpreted as one source of entrepreneurial opportunities (Audretsch et al. 2006). Thus a high level of output implies a large market size. But even a high level of output may not create limitless opportunities for entrepreneurs in the economy. Diversity of activities is also essential. Urbanisation fills this gap. 'Urbanisation economies' imply a much more diversified demand structure and may offer advantages of flexibility secured by a diversity of activities which tends to prevent a process of negative lock in (Lambooy & Boschna, 1998; Lingthelm, 2010). More dynamic and diversified the market is, the greater the perception of opportunities (Sune and Panisello, 2013). Urban areas usually attract (small) businesses because of existing infrastructure consisting of other businesses, financial advisory and educational institutions (Verheul, Wennekers, Audretsch and Thurik, 2000). Moreover urbanisation may also decline the willingness of people to conform to the old practices of living. Therefore agglomeration of higher output level and urbanisation contributes to the development of higher quality of Institutional environment for entrepreneurship by creating more opportunities and a larger market size. Smith expressed that how the division of labour is limited by the size of the market (Hall and Sobel, 2008). GEM (2011) has recognised the efficiency enhancing capability of market-size in entrepreneurship.

Size of Government

Larger size of the government activities limits the opportunities for private entrepreneurs. In general, a large state sector militates against entrepre-

neurial activity, both via state revenues and expenditures (Aidis, Estrin and Mickiewicz, 2009). Studies (Bruce and Deskins, 2010; Aidis, Estrin and Mickiewicz, 2009) have found negative effect from the size of the state sector on entrepreneurial activity which means states or regions with larger size of governments, as measured by state expenditures per capita or other means, tend to have lower entrepreneurial shares. Moreover Fogel et al. (2008) argue that generally direct government activism favours large established corporations which adversely affect entrepreneurship. Economists advocate economic freedom conducive for entrepreneurship and smaller government size is a component of that. Harper (2003) explains economic freedom as freedom of entrepreneurial choice, freedom to enter and compete in markets, freedom of exchange and freedom of contract. High level of government size and activities curtail these economic freedoms through taxes, licenses and other means. Though there is a consensus regarding negative effects of larger government size on entrepreneurship, the magnitudes, signs and statistical significance of the taxes have not been conclusive. Additionally various countries treat income from different sources differently, therefore any generalisation is not possible. Aidis (2005) recognised high level of taxes as a formal barrier to entrepreneurship. Empirical Studies like (Bruce and Deskins, 2010; Hansson, 2012; Calvez and Bruce, 2013 generally indicate that taxes have statistically significant but very small and scattered effects on entrepreneurship. It can't be argued that tax should be lowered but one can definitely argue that government size should be kept small for development for entrepreneurship.

Income Distribution

Income distribution is one of the variables considered as the determinants of Institutions. Inequality crucially shapes Institutional subversion and is detrimental to the security of property rights as it enables the rich to subvert the political, legal and regulatory Institutions of the society for their own benefit (Glaeser, Scheinkman and Schleifer, 2003).While equal distribution of income provides equal opportunities to all so that everyone has the incentive to better themselves and to participate productively in the society; inequality leads to some individuals to take decisions that is against their interests in the lack of choices. To some extent, it is the persistence of wealth inequality not the entrepreneurial efficiency which determines the activities chosen by individuals. A high level of inherited wealth inequality is the primary determinant of occupation because wealthy agents can invest in capital and profitably exploit cheap labour (Ellis and Bernhardt, 2000). Moreover inequality facilitates that Institutions remain captured by groups of powerful whose actions are oriented to particular interests rather than common good. It favours corruption and rent seeking behaviour rather than entrepreneurship (Alonso & Garcimartin, 2009). Strong inequality also causes divergent interests leading to conflicts, socio-political instability and insecurity. Acemoglu et al. (2002) argue that a society in which a very small fraction of the population for example, a class of landlords, holds all wealth and political power may not be the ideal environment for investment , even if the property rights of this elite class are secure. On the other hand GEM (2011) recognises that societies are more likely to realise the full potential of their entrepreneurial human resources when it is available to all. Equality leads to social and economic inclusivity. Access to wealth is positively *and significantly correlated with the probability of becoming self-employed; as the equality improves fewer agents are wealth constrained (Ellis and Bernhardt, 2000; Hansson, 2012). The greater the degree of social and economic inclusion the larger the potential pool of participants available to contribute to the creative process essential for innovation (Wolfe & Bramwell, 2008).*

Education

Human capital is an important aspect of the supply of entrepreneurship. Education lets latent entrepreneurs realise that opportunities exist. It may be difficult to train people to discover opportunities; but it is possible to make them capable to assess such opportunities once perceived through education (Leibenstein, 1968). Therefore education is not a robust determinant of self-employment but it is a strong determinant of entrepreneurship (Henrekson and Sanandaji, 2014). Fogel et al. (2008) argue that higher general level of education makes a greater fraction of population available as entrepreneurs. Moreover a more educated population demands more transparent and dynamic Institutions and permits to build those (Alonso & Garcimartin, 2009). Education has been recognised for enhancing efficiency of entrepreneurship development by GEM (2011). On the other hand low education level may constrain the participation in entrepreneurship and is considered as environmental barrier of entrepreneurship by Aidis (2005). An important risk (potential) investors and business owners face in developing countries is insufficient or inadequate availability of educated and skilled personnel which limits entrepreneurship in these countries. The positive relationship between education and entrepreneurial trial and success is supported by the studies of (Nikolova & Simroth, 2013; Aidis, Estrin and

Mickiewicz, 2009; Acs & Szerb, 2010 and Gupta et al., 2014). Hay and Camp (1999) conclude that the larger a country's investment in education at the tertiary level, the higher the rate of new firm formation (as cited in Verheul et al., 2000). Bruce and Deskins (2010) find that U.S. states in which a larger share of the adult population holds a college degree tend to have higher rates of tax-based entrepreneurship.

Availability of Information

Availability of information is a vital component in the process of innovation. Access of people to relevant information through various communication means and media sources determines the rate of entrepreneurship. For example Harper (2003) illustrates that the informal communication of the price differences of the same good at different places create entrepreneurial opportunities. Lack of information may constrain the entrepreneurial activities even though opportunities exist. On the other hand larger information access reduces the transaction cost which is an important barrier in entrepreneurship development. There are endless opportunities for people to improve their position by gaining more or better information (Godin, Clemens and Veldhuis, 2008). Additionally greater transparency through media lead to more accountable Institutions and lead to a more active and demanding citizenry and thereby better Institutions. Mass media by contributing to social transparency raises people's willingness to challenge established elite (Fogel et al., 2008; Subramanian, 2007).

Credit or Finance

It is unreasonable to imagine any development of entrepreneurship without adequate amount of credit or finance. Schumpeter pointed out that the importance of credit cannot be dissociated from entrepreneurial action (as *cited in Croitoru, 2012). While credit constraint may limit entrepreneurship, its availability facilitates that. Improving access to finance boost the entry rate and growth of firms, on the other hand lack of credit desists entrepreneurs from starting a business even though there are availability of opportunities. Entrepreneurship is less likely to take the form of start-ups when capital market imperfections make it difficult for them to secure financing. Aidis (2005) recognised lack of funds for business investment as environmental barriers to entrepreneurs. Studies have considered access to finance or credit as one important element of Institutional quality for entrepreneurship and lack of it as a key impediment to entrepreneurial development (GEM, 2011; Estrin & Mickiewz, 2010; Dinh, Mavridis and Nguyen, 2010; Ellis and Bernhardt, 2000).*

Political and Policy Stability

The political instability creates uncertainty among the investors and therefore discourages them to take risks in the expectation that policies will not remain stable. Uncertainty provokes firm to conduct routinized behaviour; which limits to a large extent available options (Lambooy & Boschna, 1998). Only under a certain and stable Institutional framework do entrepreneurs have incentive to invest and innovate. It is believed that a politically stable country or region will have lower levels of risk and transaction/contracting cost and higher levels of predictability and accountability. Frequent changes in government may make leaders less likely to accept the obligations of previous government. Moreover political instability creates fear of replacement among the leaders which make them more likely to expropriate and be corrupt rather than to develop better Institutions (Knack and Keefer, 1995). Dutta, Sobel and Roy (2013) find that political stability *within a country does indeed lead to an increased rate of entrepreneurship and wealth creation.*

Openness

Trade openness expands markets, constrains local monopolists; and introduces new ideas. It promotes competitive environment and creates demanding and dynamic environment. Openness in the form of international trade and investment stimulates competition and entrepreneurship. It can facilitate learning processes and good practices imitation from other countries experience. The studies of (Alonso and Garcimartin, 2009; Fogel et.al, 2008; Acs and Szerb, 2010) advocate for openness of an economy for better institutional quality and entrepreneurial development. On the other hand the study of Schloman, Stel and Thurik (2014) in case of OECD economies suggests that economic openness plays a role in creating entrepreneurial opportunities but related to a country's cyclical performances. When economies are booming, the share of self-employment may be increasing in the medium or long run but it may be opposite in case of recession or slow growth. Therefore it is difficult to make general conclusive statement.

Other than the above mentioned objective indicators and/or determinants of Institutions, Social Institutions are equally important. Social Institutions are concepts such as norms, beliefs, trust and civic cooperation, which coincide largely with informal constraints of Institutions according to classification. Social Institutions are referred in many forms as social capital or social networks. The role of social Institutions should be seen as complementary in understanding the role of other Institutions (Krasniqi and Kume, 2013). Many of these informal Institutions (customs, traditions, norms, religion) change very slowly-on the order of centuries because of their embedded-

ness. These Institutions may be significant in determination of entrepreneurship but are often non-calculative (Williamson, 2000). For example authoritarian and hierarchical societies fail to honour self made success and provide social status to innovators, which is surely a constraint to entrepreneurship. Similarly lack of trust and cooperation may limit economic transactions and thereby innovation.

Conclusion

The notion that Institutions affect the level of entrepreneurship can hardly be questioned today. Institutions of property rights, rule of law and many others may result entrepreneurial quality differences across the states, regions or countries. Institutional prerequisites or determinants such as market size, income distribution, education, information availability and credit accessibility are important context specific variables of entrepreneurship. The availability and quality of these variables determines the opportunities available to entrepreneurship. The acknowledgement of weakness of a state on a particular indicator may provide a room for development by improving these constraints rather than simple policy making. After all there is not a perfect but only a partial substitution that exists among the elements of the system. Policies and incentives may somehow lead to sharp outbreak for some time; but it may lose the pace afterwards in the lack of complementary Institutions. On the other side with a strong and balanced Institutional framework a region can develop productive entrepreneurship with a subsequent job growth in the region. It becomes capable to even catch up and accommodate innovations outside the region. Thus Institutions should be strengthened to have a strong entrepreneurial growth which is one of the prime components of development.

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