

# HOW DO DEVELOPING COUNTRY ENTREPRENEURS NAVIGATE EXTREME INSTITUTIONAL VOIDS?

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## INTRODUCTION

In an attempt to broaden our understanding of how institutions inform the ‘rules of the game’ with respect to entrepreneurship in emerging economies, we explore the modern, yet largely overlooked, challenges confronting entrepreneurs in contexts with severely lacking or wholly absent institutions. We place specific emphasis on the study of *institutional voids*, a term originally coined by Khanna and Palepu (1997; 1999; 2000) to account for the macro-level “absence of specialized intermediaries, regulatory systems, and contract-enforcing mechanisms” (Khanna, Palepu, & Sinha, 2005: 63). While previous research has uncovered the significant cross-national variation in the level of quality and the relative efficacy of institutions (e.g., North, 1990), scholars have recently noted that the study of institutional voids has been largely dedicated to deficiencies in formal institutions (Webb, Kistruck, Ireland, & Ketchen, 2010: 562).

The focus on formal voids is not inherently problematic, but when we consider how entrepreneurs in various emerging economies rely on informal institutions—culture, traditions, relational conventions, and localized norms—to compensate for ineffectual formal institutions (Puffer, McCarthy, & Boisot, 2009), there is an unqualified presumption that informal institutions are free of voids and able to operate in the absence of formal voids. In this case, a compensatory system yields a functional institutional environment that is capable of fostering and sustaining entrepreneurship (Ahlstrom & Bruton, 2006); however, when this does not occur, the functioning of markets become significantly impeded (Mair & Marti, 2009: 422).

Building on the current understanding of institutional voids, we define extreme institutional voids as institutional environments that have concurrent formal and informal institutional voids, which compromise the ability for robust institutions to compensate for weaker institutions. Specifically, when country environments have been compromised by a severe lack of security, justice, or individual mobility, there emerge both formal and informal institutional voids. Thus, beyond possessing deficient (formal) regulatory structures, there are simultaneous constraints on the most basic freedoms within society, such as the ability to move freely within and between geographic borders, or the inability to draw on dependable cultural norms within business exchanges. Working from this definition of extreme institutional voids, in this paper we explore two basic questions: (1) what are the acute challenges faced by indigenous entrepreneurs in emerging economies amidst extreme institutional voids? and, (2) what theories can be leveraged to study the role of extreme institutional voids within entrepreneurial processes? In answering these questions, we provide three specific contributions to the research domain of how institutions matter within emerging economies. First, as a contribution to institution-based theories, we introduce and discuss the unique concept of extreme institutional voids, which, we assert, offers a valuable—but as of yet, an unconsidered—area for future

scholarship within this theoretical domain. Second, we provide a contribution to future empirical research pursuits, by exploring how recent entrepreneurship theories, such as bricolage, effectuation, and cultural entrepreneurship may offer constructive insights for studying extreme institutional voids. Third, we contribute to the practice of emerging economy entrepreneurship by placing focal emphasis on an underrepresented actor, the indigenous entrepreneur within the least developed emerging economies (e.g., Mair & Marti, 2009). With these contributions to theory, empirical inquiry, and practice, we provide a more nuanced understanding of how indigenous entrepreneurial firms that lack access to the most basic resources and market opportunities can persist amidst extreme institutional voids (Bruton, Ahlstrom, & Obloj, 2008).

## **INSTITUTIONS AND EMERGING ECONOMY ENTREPRENEURSHIP**

### **Formal and Informal Institutions**

Institution-based theories have been widely explored in the fields of political science, economics, sociology, and organization studies. Given that diverse disciplines have engaged with institutional theory, the concept of ‘institutions’ has varied (Greenwood, Oliver, Sahlin, & Suddaby, 2008: 4). Scott (1995: 33, emphasis added), for instance, defines institutions as “regulative, normative, and cognitive structures and activities that provide *stability* and *meaning* to social behavior”. Most pervasively cited within institution-based research on emerging economies is North’s (1990: 33) description of institutions as the “rules of the game”, which he defines more literally as “humanly devised constraints that structure human interaction” and classifies institutions as being either formal or informal. According to North (1990), formal institutions are the rules enforced through political, legal and economic systems, which account for aspects such as judicial systems, military and government. Informal institutions are a region’s localized codes of behavior and are manifest through predictable social or cultural features within daily life (North, 1990). Adopting the formal and informal distinction of institutions, Peng and colleagues propose an institution-based view (e.g., Peng, 2002; Peng & Khoury, 2009; Peng) to account for the overlapping perspectives of Scott and North and to develop a basic framework for studying various elements of strategy and entrepreneurship, such as market entry, resource access, transaction scope, relationship dynamics, firm survival, and economic development.

### **Extreme Institutional Voids**

The concept of “institutional voids” is largely tied to the works of Khanna and Palepu (1997) to characterize the macro-level country conditions that lead to a deficiency in formal institutions, such as national governance systems. Indeed, as Khanna and Palepu (1999: 126) observe, “when institutional mechanisms are underdeveloped or missing, transaction costs rise, and the economy’s scope and growth is limited accordingly”. Thus, with ineffective or corrupt governance systems and atrophic property rights regimes within emerging economies, formal institutions fail to promote enterprise (e.g., Khoury & Peng, 2011), and, in these cases, businesses are more commonly guided by compensating informal institutions or relational forms of economic and social exchange mechanisms, such as the use of cultural conventions, family and political connections, or non-traditional markets (e.g., Assaad, 1993; Webb et al., 2009).

In many emerging economies, the ability for informal institutions to compensate for formal institutional voids may occur with great predictability, stability, consistency, and

meaning, but there exist various conditions within the least developed emerging economies where this system is compromised, leaving the simultaneous presence of formal and informal institutional voids. Informal institutional voids may be found when relationship- or culture-specific behavior, such as that commonly expected within the conventions of typical social and economic exchanges, cannot occur with predictability, stability, consistency and meaning as they normally would as dependable and durable features of the informal institutional environment. The resulting extreme institutional voids can be found when any of these three basic ‘realities’ exist within a regional context:

- (1) Challenges in basic *security*, which threatens an individual’s safety and daily priorities;
- (2) Whether through the absence or presence of direct intervention, there exist no systems of *justice*, such as penalties or sanctions for unlawful behavior or instances of property misappropriation; and,
- (3) *Individual mobility*, such as the basic freedom of travel or the permissive transport of goods as features of an individual’s civil liberties, are constrained, which limits essential processes of social and economic exchange.

Taken collectively, extreme institutional voids are present when ‘fallback’ informal institutions cannot viably compensate for failed formal institutions.

### **How Extreme Institutional Voids Affect Entrepreneurship**

Most relevant to the emerging economy entrepreneur’s experience is how the specific challenges posed by extreme institutional voids constrain the ability to: (1) access market opportunities, and, (2) acquire and mobilize resources in order to compete (Barney, 1991). Basic access to market opportunities and resources are required to engage in the process of discovering, evaluating, and exploiting entrepreneurial opportunities (Alvarez & Barney, 2005), and without access, the most central entrepreneurial processes are fundamentally restricted. By illustrating the challenges posed by a lack of security, inadequate justice, or individual mobility constraints, we highlight how entrepreneurial processes are significantly undermined.

Lacking security may be present through trans- or intra-national violent conflict, societal unrest as expressed through social or political movements, sudden catastrophic natural disasters, limited access to necessary levels of energy, water, housing, medical care and food resources, or foreign occupation. A lack of security severely compromises the entrepreneur’s protected access to and mobilization of resources, which removes any predictability within daily enterprise pursuits. This severely compromises the entrepreneur’s ability to forecast, stabilize fixed production costs, or to compete with cost-based strategies, given the inability to minimize transaction costs around, what should otherwise occur as, more routine, predictable transactions.

Without appropriate consequences in place for social and economic injustices or the absence of a fair and systematic legal system, entrepreneurs face compounded risks of financial exposure. For instance, in a regional context that has an ineffective set of laws and regulations, entrepreneurs may experience the misappropriation of property, which, without proper avenues for rectification, prevents them from harnessing the value of their property-based resources (Goodstein & Velamuri, 2009). Such challenges may be manifest by instances of cronyism, corruption, judicial impartiality, or political hazards. Beyond these however, systems of justice typically upheld by specific government offices may be missing or “on hold” due to situations of political and social unrest, natural disaster, war or foreign occupation. Similar to the challenge of

security, a lack of justice compromises the firm's ability to accurately assess market opportunities, and commit investment into the resources required to support those opportunities.

Perhaps, the most detrimental challenge posed to indigenous entrepreneurs and direct threat to informal institutions is the lack of consistent individual mobility, such as the freedom to move within and between state boundaries. Both the entrepreneurs and their employees encounter profound challenges in forming relational commitment to one another and their suppliers, and the entrepreneur's ability to fulfill employment contracts or leverage trust within relational contracts (Puffer et al., 2009) are subject to daily unpredictable constraints. This could be the corollary of an active war, separatist policies, imposed curfews, or military checkpoints.

Regardless of how this challenge unfolds, the consequence is that the entrepreneur's ability to reach basic markets is vulnerable. For instance, the use of frequent or long-term face-to-face means of communication, a strong informal institutional feature in various cultures, would be under physical or moral constraint. This limits the use of familiar forms of cultural traditions, expressions, and norms within economic exchanges (e.g., Assaad, 1993), which creates various challenges in the ongoing strategic management of human resources and external relationships. Without the freedom of individual movement or the ability to effectively communicate with various actors relevant to entrepreneurial processes, employee mobility, productivity, and work quality cannot be managed dependably. Under such conditions, this undermines the value of investing in the development of organizational culture or internal social capital as key firm-level resources. Effective contracts between employers and employees and between ventures and their suppliers, as a basic mechanism of accomplishing the 'work' of the venture, is also not available. Moreover, there are extreme challenges to investing in supplier and customer relationships by not being able to build relational capital with these partners.

Moreover, the severity of daily life in these settings imposes multiple and severe constraints on the mobilization, combination, and deployment of resources towards market opportunities (e.g., Barney, 1991). Under such conditions, the strategic repertoires available to firms are highly confined. When available resources and strategies are limited, the tactics of successful firms become more apparent and transparent to outsiders, which diminish a venture's ability to deter competitors through the mechanism of causal ambiguity (Barney, 1991).

## **ENTREPRENEURSHIP THEORIES AMIDST EXTREME INSTITUTIONAL VOIDS**

In considering contemporary theories of strategic entrepreneurship (Hitt et al., 2011), various perspectives could benefit from empirical investigations within regions marked by extreme institutional voids (Peng et al., 2008; Wright, Filatotchev, Hoskisson, & Peng, 2005). However, we contend that three theoretical perspectives of entrepreneurship are particularly valuable to studying the impact of extreme institutional voids since these views place critical value on the entrepreneur's interpretation of a particular situation or context (Welter, 2011). These are the concepts of *bricolage*, *effectuation*, and *cultural entrepreneurship*.

### **Bricolage**

Acclaimed anthropologist and ethnographer Claude Levi-Strauss (1966) conceived the notion of bricolage to refer to situations where one "makes due with the resources at hand" in working towards an outcome. In its more recent application in the field of entrepreneurship, the concept of bricolage refers to 'making due' with available resources towards the creation of a

new product or market opportunity is contrasted with the more classical strategic design of ‘seeking and acquiring’ the resources necessary to realize opportunities (Baker & Nelson, 2005). Perhaps more germane to entrepreneurs within emerging economies (Mair & Marti, 2009), this view of entrepreneurship emphasizes the constraints on resources and strategies available to entrepreneurs without the guides of robust institutions (Baker, Gedajlovic, & Lubatkin, 2005). Per Baker et al. (2005), Shane and Venkataraman’s (2000) proposal of the entrepreneurial process could accommodate more contexts with respect to how institutions of varying quality challenge the assessment of prospective opportunities and their corresponding opportunity costs.

Emphasizing that the entrepreneur’s unique mindset may represent a resource-based advantage, cognitive theories of entrepreneurship highlight that the entrepreneur may be distinctively poised to confront opportunities (Autio, George, & Alexy, 2011). Independent of the individual’s entrepreneurial capabilities, various features of the institutional environment can influence the entrepreneur’s ability to recognize or embark on perceived opportunities. For instance, the notions of risk, legality, wealth maximization, and control are embedded within informal institutions, and these individual factors clearly have salient impacts on the entrepreneurial process (Baumol, 1990; Busenitz et al., 2000; Webb et al., 2009). Amidst extreme institutional voids, such informal institutions may be absent, which may place the understanding, meaning, and universal interpretation of cultural norms on hold. In turn, the cultural conventions of what constitutes a realistic aspiration or the understanding of how much control the entrepreneur has within their means are fundamentally unclear within the entrepreneurial process. The concept of bricolage may offer a valuable lens in studying the interpretation of what is ‘within the means’ of the entrepreneur when both formal and informal institutional voids simultaneously exist and compensatory systems are challenged.

## **Effectuation**

In emphasizing the cognitive, first person perspective of the entrepreneur, the concept of effectuation depicts the entrepreneur as taking “a set of means as given and focusing on the selection between possible effects [or outcomes] that can be created with that set of means” (Sarasvathy, 2001: 245). An effectuating entrepreneur emphasizes the *realizable* goals within the broad opportunities sought versus the orchestration of resources to *maximize* obtainable opportunities at hand, and these realizable opportunities are constrained by the means available to the entrepreneur (Sarasvathy, 2001). Thus, the assessment of opportunity occurs when entrepreneurs reconcile the institutional environment they face versus the strategic choices they can make to shape their entrepreneurial trajectory (Baker et al., 2005).

Amidst extreme institutional voids, there exist simultaneous gaps in both formal and informal institutions, which imposes an acutely harsh limitation on, not only the resources available for acquisition, but also on the penultimate choices available to the effectuating entrepreneur. In response to the daily oppressions and hardships that are created and/or aggravated by extreme institutional voids, the entrepreneur faces severe and constantly changing obstacles, where the abilities to improvise and ‘effectuate’ with fewer viable strategic choices (Sarasvathy, 2001) may represent the most valuable tactics that these entrepreneurs can leverage within such market environments. By emphasizing how unpredictable the entrepreneur’s future may be, there exist valuable opportunities to see how effectuation processes play out given drastic limitations on the available resources choices at hand.

## **Cultural Entrepreneurship**

Building on the assumption that a context-specific “cultural component” exists within entrepreneurship, we also explore the application of cultural entrepreneurship, which Lounsbury and Glynn (2001: 545) define as “the process of storytelling” that entrepreneurs engage in so as to obtain legitimacy or other forms of critical capital necessary to acquire and mobilize resources towards wealth creation. In acknowledging the contingent value and the need to tell stories that help convey a venture’s position and challenges in realizing market opportunities, it becomes apparent that the venture’s environment can inform the utility of a story in helping realize critical outcomes. Thus, under austere living conditions in the least developed emerging economies, where extreme institutional voids are present, stories of severe challenges and daily hardships convey the entrepreneur’s resilience and perseverance to survive (Seelos & Mair, 2007).

The value of stories when extreme institutional voids exist is context dependent. Stories of resilience and overcoming trials of hardship may only have value when such stories are differentiated from those of peer ventures. For indigenous entrepreneurs in pursuit of local or regional market opportunities, their stories may hold less value due to the common understanding of the shared hardships and challenges posed by extreme institutional voids. However, when indigenous entrepreneurs are pursuing markets outside of their institutional environment, their stories may earn them a badge of entrepreneurial wherewithal and perseverance. Products or firms that are able to convey their stories in these markets may be able to penetrate those with supportive values and those sympathetic to related causes to purchase products (i.e. like-minded consumers) or engage in business with firms (i.e. like-minded suppliers) originating from countries facing extreme institutional voids. In short, the entrepreneur’s environment becomes part of the product, and the story illustrates the social context in which entrepreneurship occurs. Thus, we contend that the concept of cultural entrepreneurship can be leveraged to study how and under what conditions the entrepreneur’s story matters to creating and fostering opportunities amidst extreme institutional voids.

## **DISCUSSION**

In this article, we present three key contributions. First, as a contribution to institution-based theory, we introduce and discuss the unique concept of extreme institutional voids, which, we assert, offers a valuable and unconsidered area for future scholarship within this research domain. In this article, we present the exception to the situation of formal voids and compensatory systems, where informal institutions may also be absent or challenged, thus, giving rise to extreme institutional voids. Second, we provide a contribution to future empirical research pursuits, by exploring how more recent entrepreneurship theories, namely bricolage, effectuation, and cultural entrepreneurship can offer valuable lenses for empirical inquiry within extreme institutional voids. Third, we contribute to the practice of emerging economy entrepreneurship by considering how indigenous entrepreneurs overcome the acute challenges posed by extreme institutional voids. Further emphasis on these settings will allow us to better understand how such voids shape, limit or facilitate the indigenous entrepreneur’s ability to organize resources in pursuit of entrepreneurial opportunities (Bruton et al., 2010; Webb et al., 2009).

## **REFERENCES AVAILABLE FROM THE AUTHORS**