

# **Environmental conditions affecting corporate entrepreneurship**

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**Abstract:** In this paper we propose a conceptual framework based on Douglass North's approach to Economic Institutional Theory to analyze how intrapreneurship or corporate entrepreneurship is affected by environment. The interaction between institutional structure (the rules of the game) and companies (the players) is very important for long-term economic development of countries. Institutions create incentives and opportunities determining what kind of knowledge and skills must companies tend to invest in to be successful. And companies, in the pursuit of their objectives, alter the institutional structure and provoke change. The conceptual model of Global Entrepreneurship Monitor project reflects since 2011 the influence of the phenomenon of intrapreneurship in those regions where it collects data, so it will be a very important source of information for future research on this issue.

**JEL:** L26 – Entrepreneurship; M13 - New Firms; Startups; O17 Formal and Informal Sectors; Shadow Economy; Institutional Arrangements

**Keywords:** Intrapreneurship, corporate entrepreneurship, environment, Institutional Theory.

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## 1. Introduction

The aim of the study is to deepen in the understanding of the environmental factors affecting intrapreneurship or corporate entrepreneurship, what it can be understood as entrepreneurship in an existing organization.

The environment conditions in a global market make that settled organizations adopt entrepreneur strategies as a way to success (McGrath, R.G. and MacMillan, I.C., 2000); (Morris, M.H., Kuratko, D.F. and Covin, J.G., 2008).

It has been verified (Schwab, K. et al., 2010) that countries and regions go through different phases in their development. In the beginning, there are economies based in the traditional production factors, in which the extraction processes of raw materials are the main source of exports and wealth generation. In a next stage, there are economies based on the efficiency of the production factors, because the intensiveness of production is the main element of exports and wealth generation, and it is based, for example, in acquiring economies of scale. And in the most developed stage, there are economies driven by innovation, in which the main factor to generate wealth and exports is the production of new products and services, created by big innovations and that many times are pioneers in the market.

As the country goes through these different stages of development, and the factors that hold its economy change, it is verified how the environment factors that boost the entrepreneur activity also change.

So, in the first stage, the main requirements are the basic conditions such as health care. In the second one, the objective is to push the activity of those entrepreneurs driven because they detect an opportunity more than those others which are driven because they need an income source, so the objective is to promote the efficiency in the production factors. And in the last one, as the developed economies already have the basic requirements and the efficiency ones, what they try to push es the innovative character and the orientation to growth of the new projects.

As we will see, the Economic Institutional Theory, with the approach proposed by Douglass North (1990), gives a theoretical framework to analyse how environmental factors affect intrapreneurship. Its approach allows to understand the different kinds of human interaction in the general frame of established rules of the game (property rights, commercial law, incorporation procedures, cultural beliefs, ideas, attitudes, etc.) that influence favourably or unfavourably in economic development, and as a result of it, in business creation (North, 1990).

We also review the state of the art of research on intrapreneurship, and we extract some information from Global Entrepreneurship Monitor survey, which will serve as data source for the empirical contrast.

In this sense, it is important to note that this is the first of what it is expected to be a deeper and more extensive research.

This issue is relevant both at theoretical and practical level. In fact, it is relevant under three points of view, different between them but complementary: academic, business and policy.

- a) From the academic point of view: although it has been studied the effect of institutional environmental factors (formal and informal) on

entrepreneurship, the analysis whether there are differences when it comes to business arising from already existing businesses it is not enough.

- b) From the business point of view: the study can serve as guidance to companies in the intrapreneurial process, which may have beneficial effects on the growth of the company and its profitability, measured both in absolute and relative terms.
- c) From the point of view of economic policy: the study can be used to adjust the supply of supportive measures to the needs of companies. Increasingly, economic growth, new jobs generation and business innovation concern society and various governments and public administrations. And the creation of new firms affects simultaneously in the solution of the three mentioned problems.

## **2. Intrapreneurship and environmental conditions**

As we said above, the aim of the work is to study how the environmental factors affect intrapreneurship, for what we will use the conceptual framework of Economic Institutional Theory as explained below.

In this way, authors as Urbano, Díaz Casero y Hernández Mogollón (2007) proposed to use the principles of Institutional Theory to analyse the impact of environmental factors over the entrepreneurship phenomenon.

Tolbert et al. (2011) note that to date there have been few published analysis of entrepreneurship using the Institutional Theory focus. One reason may be the different background of the academics of each discipline, as there are mainly sociologists in one side and business school economists in the other. In the last two decades there have been one or two articles using this focus in the main magazines of entrepreneurship, although in 2008 there was a rise to eight papers.

Historically, the Resource Based Vision (Barney, 1991) had been one of the main theories to analyse entrepreneurship as the access to resources is crucial to start a business (Bhide, 2000).

But, although the resources are important, it is increasingly clear that issues as culture, legal environment, tradition, economic incentives and others can affect to a sector, and therefore, to entrepreneurial success (Baumol, W.J., Litan, R.E. and Schramm, C.J., 2009). Institutional Theory facilitates the approach to identify and address these issues because these authors state that the entrepreneurial level of a society is directly related with the society regulations and the policies controlling the incentives fixing.

### **2.1. Institutional Theory: Douglass North's approach**

North develops a complete theory about institutional change to understand the different performances of economies over the time, giving significant importance to the culture and history of different countries and regions.

The Institutional Economic Theory is adequate to analyse how environmental factors affect the creation of companies (Veciana, 1999) since goes further than

pure economic matters to study how political and socio-cultural factors affect the behaviour of individuals (Urbano, 2006).

We will use the conceptual framework proposed by Douglass North in his work *Institutions, Institutional Change and Economic Performance* (1990). North bases himself on the neoclassical theory and assumes the scarcity hypothesis and analysis tools of classical microeconomic theory, but he refuses and modifies the instrumental rationality hypothesis considering that the information is incomplete and that a subjective model of reality exists. He adds that institutions do not fit the assumption of instrumental rationality and takes into account the temporal dimension which is ignored by the neoclassical analysis.

North says that institutions are the rules of the game in a society or, more formally, are the standards developed by society to govern relations between people. And in his book, he analyses institutions, changes occurring to them and their effects on economic performance over time.

This involves using the concept "institution" very broadly, as institutions would be restrictive standards and rules that govern society, conditioning the framework of relations that occur to them. And institutions affect economic performance since the actions of the various actors in society are conditioned by the existing institutional framework by the structure of incentives and opportunities.

The process of cumulative learning in human beings develops over time and is transmitted from generation to generation by their cultural beliefs and, in this manner the institutions are developed. Therefore, time is the dimension in which collective learning processes are shaping the institutional evolution through continuous elections (North, 1994).

North distinguishes between institutions, that as it said above, are the rules, regulations or public policies; and organizations, that would be the players, groups of individuals with common goals and interests. And in the end, the interactions between players and the rules can shape or change institutions. Interactions are basically elections. The players are making choices based on the cost of their actions and the benefit they expect to achieve, but these choices are often based on subjective perceptions, as they are often based on imperfect information. So sometimes their decisions and the changes they cause are not optimum for improving the welfare of organizations.

North, also distinguishes between formal (rules, laws, policies and agencies) and informal (culture, beliefs, values, ideas, habits and attitudes of society) factors.

Formal factors refer to a set of formal written rules, while informal ones refer to unwritten codes of behaviour. And both of them compound an institutional matrix that shapes the relationships of all kinds produced in the society.

Therefore, restrictions imposed by the institutional framework determine the opportunities for the birth of the organizations, as well as the type of organization that is created.

For North, organizations tend to achieve their goals (win elections in the case of a political party or maximize profit in the case of a company) and reinforce themselves acquiring skills and knowledge to ensure their survival.

If the institutional framework encourages piracy, then pirate organizations that invest in skills and knowledge that make them the best pirates will arise, and if the rewards are better for businesses if they increase their productivity, then they will invest in skills and knowledge that will allow them to increase productivity (North, 1991).

This theory states that humans are limited in their cognitive and information processing skills and, although they may be goal-oriented and full of purpose, they use shortcuts and mental models to make decisions as a result of their cognitive limits and, therefore, according to North (1990), decision-makers are influenced by formal incentives and governance systems.

In this way, means that modern societies are complex, and that the decisions of the individuals composing them are not made under conditions of perfect information, but under uncertainty, and therefore the institutional framework conditions such decisions.

North presents a cognitive scientific approach to human learning, to explain how the mind processes information. The mind seems to arrange and rearrange the mental models we construct to explain and interpret the surrounding environment, making them evolve into more abstract models to be used to process other information, going from the particular to the general. This capability is the source of creative thinking, ideologies and belief systems that underlie the decisions taken by humans.

The common cultural heritage, result of cultural learning of societies, reduces the diversity of mental models of subjects that compound the society, and serves as a mean to transmit across generations these unifying perceptions through a belief structure that is a fundamental part of society. Beliefs are transformed into social and economic structures through the institutions, both corresponding to the formal rules and the informal ones.

This way, institutions are impositions devised by human beings that structure and limit their interactions (North, 1994). Institutions reduce uncertainty because they establish a structure in which perform human interaction in daily life, determining and constraining the set of actions of individuals.

Those institutions create expectations that determine appropriate actions for organizations (Meyer, J.W. and Rowan, B., 1991) , and also create the logic by which the laws, rules and preconceived behaviors seem natural (Zucker, 1977). Institutions determine what is appropriate from an objective point of view and, therefore, also what is not acceptable or not even worth to consider (DiMaggio, P.J. and Powell, W.W., 1991).

Scott (2007) summarizes in his formulations three pillars or categories of institutional forces:

- The regulatory pillar, containing government legislation and industry standards and agreements, marking lines of action and provides a way forward for new business organizations.
- The legal foundation, representing models of individual and collective behaviour, based on that institutions, by mean of values and norms, define what is expected or appropriate in various social and business situations.

- The cognitive pillar, representing individual behaviour models that are based on rules and subjective meanings that are created, and limit the appropriate beliefs and actions.

The third pillar increasingly affects the social consideration at entrepreneurs and how to instill societal values (Bosma, N. S., Stam, F. C. and Wennekers, A. R. M., 2010).

All social systems and, therefore, all organizations exist in a social environment that defines and limits their social reality. Thus, the environment generates limitations, restrictions and inflexibilities to actions taken by organizations. In this context, Institutional Theory is useful to explain how institutions affect entrepreneurial decisions (Tolbert, P.S., David, R.J. and Sine, W.D., 2011), because if it allows to study organizations, it allows also to understand entrepreneurial processes.

## **2.2. Intrapreneurship**

Intrapreneurship, known as well as corporate entrepreneurship or corporate venturing (Burgelman (1983); Mac Millan, Block y Subbanarasimha (1986)), is the practice of developing a new business within an existing organization to exploit a new opportunity and create economic value (Pinchot, 1985).

Or as it is defined by Bieto (2008), “intrapreneurship is the set of strategies and practices that the company conducts to promote, cultivate and manage the entrepreneurial skills of the organization, and create the framework conditions to make viable the development of new ideas and business projects or the renewal of the key ideas over which the company had been created”.

There is evidence of how intrapreneurship helps managers to renew and revitalize their businesses to innovate and improve the performance of the company as a whole (Kuratko, Montagno y Hornsby (1990); Antoncic y Hisrich (2001); Ireland, Covin y Kuratko (2009)). Intrapreneurship is important for organizational survival, growth and profitability (Zahra, 1995), especially in large organizations. Moreover, Antoncic and Hisrich (2001) show how intrapreneurship is an important predictor of business performance both in absolute terms of growth (number of employees and total sales) and in relative ones (market share compared with competitors).

It is relevant, therefore, to investigate how environmental factors affect the creation of new businesses within existing organizations.

Intrapreneurship can take different forms, Sharma and Chrisman (1999) distinguish between:

- External intrapreneurship: refers to corporate entrepreneurship activities that result in the creation of autonomous or semiautonomous organizational entities that exist outside the existing organizational domain. Some examples are joint ventures, spin offs and venture capital initiatives.
- Internal intrapreneurship: refers to corporate entrepreneurship activities that result in the creation of organizational entities that exist inside the existing organizational domain, although they are treated as new businesses. For this particular case, these authors propose the four dimensions that should be considered when analyzing concrete

examples: a) structural autonomy, b) relationship with existing businesses, c) degree of innovation and d) type of sponsorship.

But these authors consider that there are other activities to be included within corporate entrepreneurship such as:

- Strategic renewal; involving changes in the strategy or in the structure of the existing organization, which would be both the instigator and the recipient of the change.
- Innovation: any introduction of a new release to market with potential to transform the competitive environment and organization. Normally, it occurs with intrapreneurship or strategic renewal. Then, innovation, in broad sense, is a common underlying theme in all forms of intrapreneurship. Covin and Miles (1999) suggest that the use of innovation, either as a mean to redefine or rejuvenate the organization, its position in the market and sectors, or the competitive environment in which the company operates, seems to be a key element of intrapreneurship.

These definitions are very broad and there may be concrete events that fit in more than one of them.

The emergence of these new activities may depend on many factors that can promote them, or barriers that may slow them.

Intrapreneurship literature has identified two main groups regarding to its background: one based on the external environment of the company, and another, on organizational characteristics.

With regard to environmental factors, some are seen as favourable to intrapreneurship (dynamism, technological opportunities, industry growth and demand for new products), while others are seen as hostile (unfavourable change and competitive rivalry).

In more detail, it is considered that:

- Dynamism, meaning the continuous change in the sectors in which a company operates, is favourable for corporate entrepreneurship because it tends to create opportunities in the markets in which it operates (Zahra, 1991). Dynamic or high-tech environments tend to take the company toward intrapreneurship (Guth y Ginsberg, 1990).
- Perceived growth may stimulate intrapreneurship, especially when a sector is perceived as declining as this is a major boost for the company to renew its activities (Zahra, 1995), and when there are sectors perceived as growing that offer opportunities for entrepreneurship.
- Demand for new products also boosts intrapreneurship, as a form of response to this demand (Zahra, 1993).
- Hostility of the environment may also foster intrapreneurial activities, to the extent that it creates threats to the organization that stimulate corporate entrepreneurship (Zahra, 1991) and the adoption of an entrepreneurial approach (Covin y Slevin (1989), Covin y Slevin (1991)). For example, two hostile environmental conditions could be, to perceive it as unfavourable to the goal and objectives of the company, and that

there is competitive rivalry, so the intensity of competition is high (Zahra, 1993).

With regard to organizational or internal factors that stimulate or inhibit intrapreneurship, previous investigations have identified the following organizational characteristics: openness in communication, control mechanisms, the intensity of environmental scanning, management support and company values.

Developing them more:

- Openness in communication (the quantity and quality of communication) is expected to be positively related, as it may be essential for success, especially to begin implementing intrapreneurship (Zahra, 1991) and, also, open communication, understood as sharing information and training is a critical element for innovation (Pinchot, 1985).
- Formal controls to monitorize intrapreneurship can be positive stimuli. While excessive use of formal methods of control can restrain it (MacMillan et al. (1984); Zahra (1991)), control and evaluation are important for intrapreneurship (Kuratko et al., 1993).
- Environmental scanning is important, as Khandwalla (1977) suggested, because it allows awareness of industry trends and changes, and opportunities and threats of environment, which is necessary for intrapreneurial activities such as innovation and the commitment to new business (Zahra, 1991) and, to that end, to collect feedback from both customers and employees is essential (Wei, C.C., Choi, C.S. and Yeow, P.H.P., 2006).
- Support of the organization is considered an important antecedent of intrapreneurship (Antoncic y Hisrich (2001); Antoncic y Hisrich (2004)). Based on previous research, key content and features that can framed within this section are: management commitment (Merrifield, 1993), support of top management, style and how to allocate resources and reward initiatives (MacMillan, 1986), training and trusting individuals within the organization to identify opportunities (Stevenson, H.H. and Jarillo, J.C., 1990), allowing organizing work, rewards, time availability, support of management (Hornsby, J.S., Naffziger, D.W., Kuratko, D.F. and Montagno, R.V., 1990).
- Organizational values are considered to be an important part of culture in an innovative organization where individuals are encouraged to continually generate new ideas, knowledge and solutions (Wong, 2005). Related drivers of intrapreneurship would be: characteristics, values, beliefs and vision of strategic leaders (Guth y Ginsberg, 1990), and the attitude within the company (Stevenson y Jarillo, 1990).

Furthermore, both antecedents of intrapreneurship (environmental and organizational), tend to be related (Antoncic, B. and Hisrich, R., 2000). Environmental play an important role in the selection and adaptation of companies (population ecology theory, (Hannan, M.T. and Freeman, J., 1977)), and tend to influence organizations to become more isomorphic (institutional theory, (Di Maggio, P.J. and Powell, W.W., 1983)).

### **2.3. *Application of institutional theory to intrapreneurship. Conceptual framework derived.***

Following the reasoning of Diaz, Urbano and Hernandez (2005) that raise the same question applied to entrepreneurship, it is interesting to apply the theoretical institutional framework proposed by Douglass North to analyse the environment and its effect on intrapreneurship because it is very pertinent.

Further developing this statement, the highlights are, as seen before, that institutions are the rules of the game of a society, i.e., the restrictions designed and imposed by humans to facilitate the interaction between them, and, on the other hand, organizations are the players, which are engaged in various useful activities.

Businesses are an important part of the economic activity, and the institutional framework determines which companies are born and how they evolve. And, in turn, these companies will influence how the institutional framework evolves.

Companies and, in general, organizations are created with a specific purpose and as a result of existing opportunities. And the opportunities that exist in a society and, therefore, the type of companies created to take advantage of those opportunities are determined by the institutions, through formal and informal constraints, together with the structure of ownership of the community.

Organizations or businesses will acquire, based on their objectives, skills and knowledge to strengthen their chances of survival.

The incentives of the institutional matrix determine the type of knowledge and attitudes that will be required by companies and organizations, and in which they will be willing to invest.

There, the institutional framework guides how the knowledge of a society evolves through its system of incentives, and this plays a role in how people interpret the world around them.

So, the institutional framework shapes the direction of knowledge acquisition, and this direction will be the decisive factor in the long-term development of that society (North, 1993).

In the same way, in the business world, the approach companies take in the long term in the direction of their knowledge can be a decisive long term development factor because knowledge represents a competitive advantage for them.

Companies or organizations, in the pursuit of their objectives, alter the institutional structure and provoke change. And this institutional change, along with technological change, is the basis of social and economic development.

The long-term economic change is the cumulative result of many short-term decisions of (economic and politic) entrepreneurs that directly or indirectly shape the economic performance at a given society. And these decisions reflect their subjective mental models.

Therefore, if the agent of change is the entrepreneur, sources of change are determined by the incentives and opportunities created by the institutional structure, which determine the skills and knowledge that employers invest in. And institutional change occurs as a result of the demands of employers as they

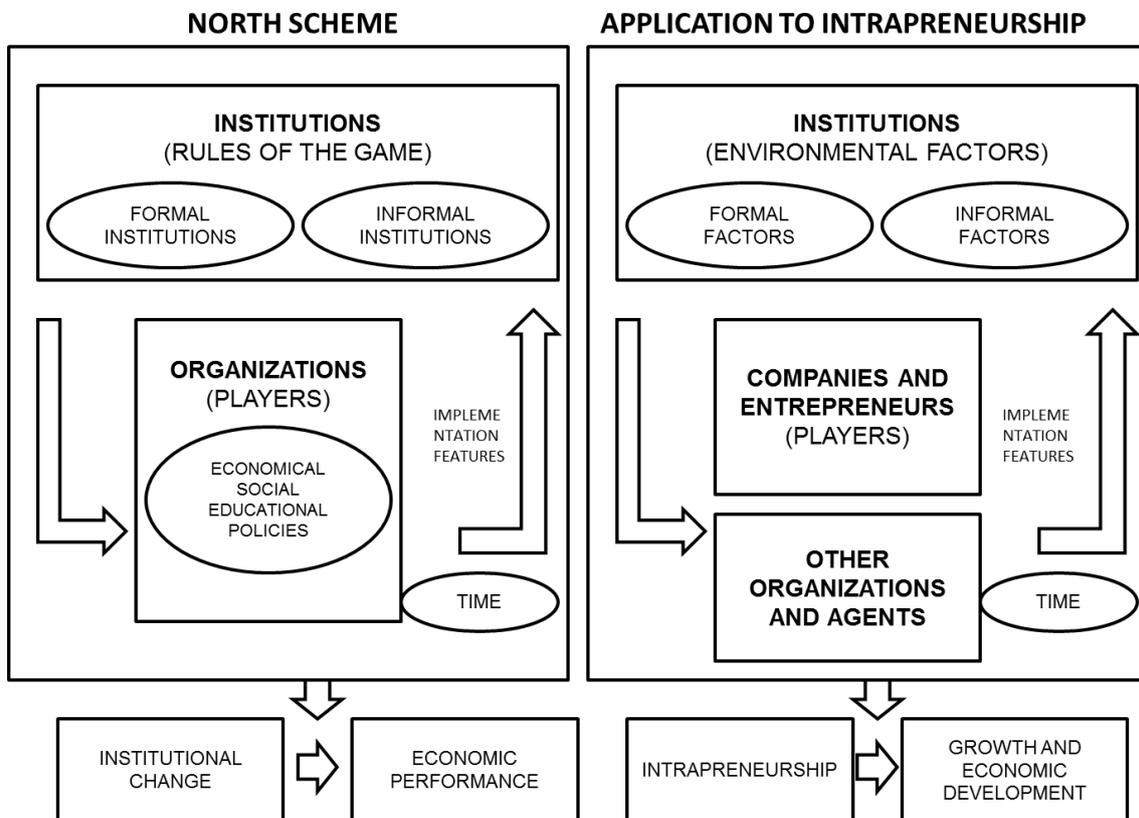
asses the gains from renegotiating their contracts or change institutional framework, being their perceptions the origins of actions for this change.

So, it can be considered that the role of institutions and organizations, companies and entrepreneurs, as catalysts is very important for long-term economic development.

For all these reasons, the economic institutional theory, from the perspective of Douglass North, is a valid reference framework to study environmental factors affecting intrapreneurship.

In the figure below is displayed a representation of the application of North's conceptual framework to the investigation of entrepreneurship and, within it, as we have explained, to the creation of companies that emerge from existing companies, that is, to intrapreneurship.

**Figure 1:** Conceptual model to study the effect of environmental factors on intrapreneurship



Source: Urbano et al. (2007)

Specifically, the formal factors taken into account will be: the economic and social policy, measures and support organizations, *Concretamente, los factores formales que se tendrán en cuenta serán: la política económica y social, las medidas y entidades de apoyo, the law on business development and its characteristics.*

And making reference to informal factors, culture understood in the broad sense.

### 3. Global Entrepreneurship Monitor (GEM) project

Global Entrepreneurship Monitor (GEM) is a world level investigation that analyzes entrepreneurial activity on a yearly basis.

The starting assumption of the GEM model is that business creation is crucial for regional growth, due to the innovation and competitiveness developed by new competitors.

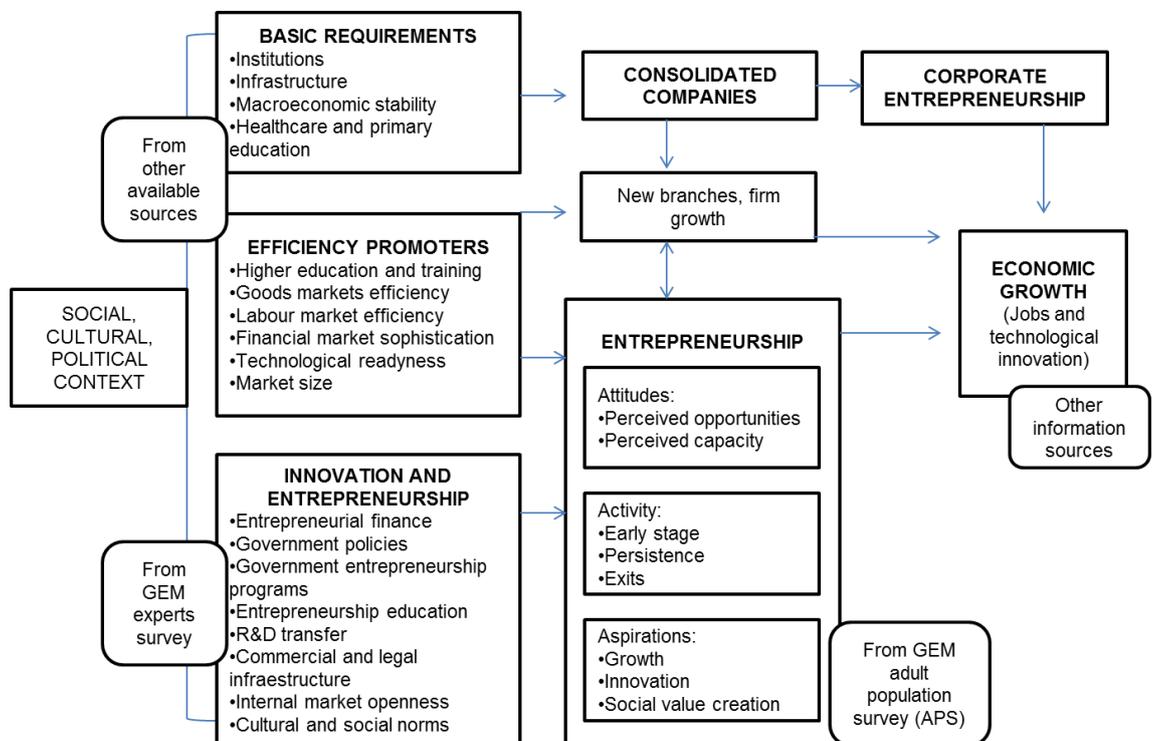
For that reason, the GEM conceptual model considers the contribution to economy of all kinds of companies, big, medium and small (Reynolds, P., Bosma, N.S. and Autio, E., 2005).

Progress in investigating the entrepreneurial phenomenon every year brings details to be incorporated into the scheme. Thus, having found that the development of entrepreneurial characteristics are related to the stage of development and competitiveness of countries, it was considered essential to capture this in the model by adding to it three subindexes of competitiveness – factor driven, efficiency driven and innovation driven. The degree of development of countries, and the status of their environmental conditions to undertake, influences the values, perceptions, skills and entrepreneurial attitudes of the population.

After the measurement in 2011 of the rate of intrapreneurship or entrepreneurship by employees of companies and government agencies, it has been considered relevant to specify the existence of this contribution to the model, so that its contribution is reflected in its upper right side.

The conceptual model is shown in the next picture:

**Figure 2.** GEM Project conceptual model



**Source:** GEM Global Report (Kelley, D. J., Bosma, N. and Amoros, J. E., 2011)

According to the model, it is considered that economic growth comes from the interplay between established businesses (in the upper part of figure) and potential businesses (in the bottom).

### 3.1. *Intrapreneurial environment*

The table below shows the comparative assessment of the environmental conditions in the opinion of the 540 experts interviewed in 15 European countries based on innovation, and the 36 Spanish experts interviewed during 2013. Each gave his opinion of the whole conditions by means of a questionnaire with 5-point Likert scale (being 1 = completely false and 5 = completely true). The ratings that exceed the average of three points can be considered favourable while those that do not exceed have to be considered as unfavourable:

**Table 1:** Assessment of conditions to undertake in countries of the European Union based on innovation, in Spain and in the Basque Country in 2013

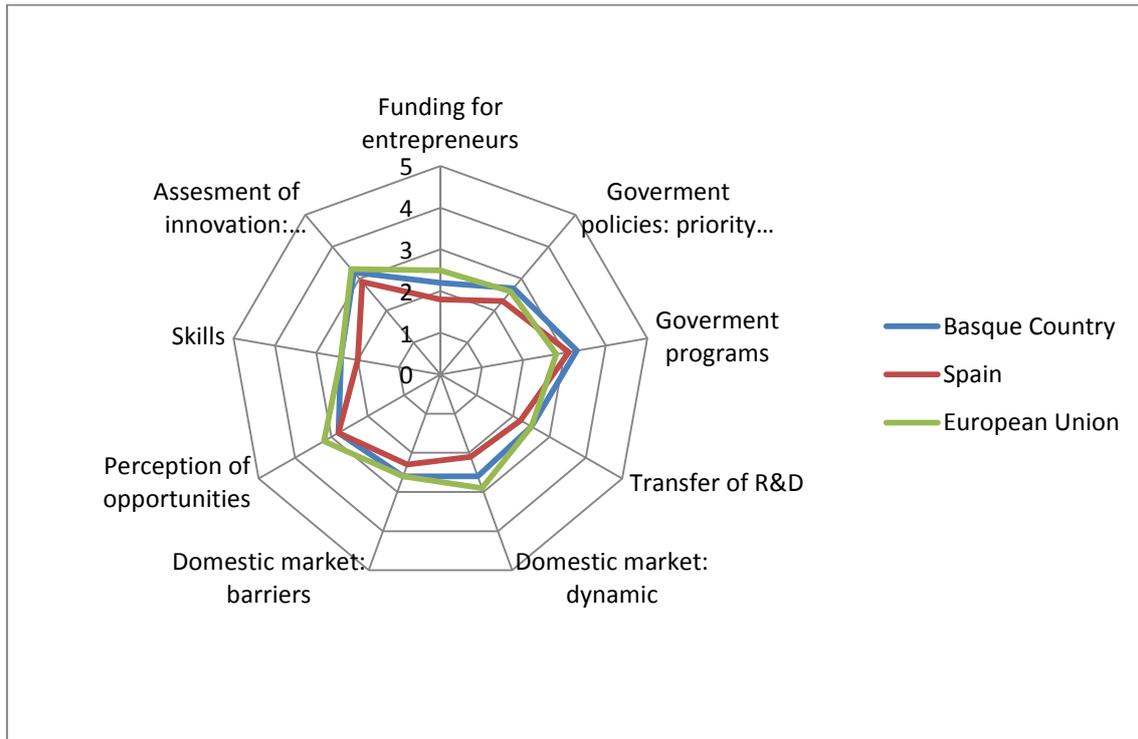
	UE	Spain	BC
Funding for entrepreneurs	2,5	1,8	2,2
Government policies: priority and support	2,6	2,3	2,7
Government policies: bureaucracy	2,4	2,0	2,5
Government programs	2,8	3,1	3,3
Education and training (school stage)	2,1	1,4	1,8
Education and training (post-school stage)	2,8	2,3	2,9
Transfer of R & D	2,5	2,2	2,5
Commercial and professional infrastructure	3,2	2,5	2,8
Domestic market: dynamic	2,9	2,1	2,6
Domestic market: barriers	2,6	2,3	2,6
Access to physical infrastructure	3,9	3,9	3,9
Social and cultural norms	2,5	2,1	2,4
Perception of opportunities	3,2	2,8	2,8
Skills	2,4	2,0	2,4
Motivations	3,3	3,1	2,6
Intellectual property valuation	3,3	2,6	3,0
Support to women entrepreneurship	3,3	2,9	3,2
Support to high growth potential	3,2	2,7	2,9
Assesment of innovation: business	3,3	2,9	3,2
Assesment of innovation: consumer	3,6	4,0	3,2

Source: GEM (2013)

It arises as hypotheses to be verified in future studies that the conditions marked in different color are the most relevant in the case of intrapreneurship.

Those specific conditions are shown more graphically in the figure below,

**Figure 3:** Average rating of experts on environmental conditions to undertake in Basque Country, Spain and European Union, year 2013



Source: GEM (2013)

All environmental conditions in Spain are below the average rating of the European countries involved in the survey to experts, while the Basque Country is close to the average and in the case of the one referred to government programs, above it.

Market dynamics and financing for entrepreneurs stand out as the two worst conditions in both Spain and the Basque Country.

But in general, at European level only nine environmental conditions have obtained favourable rating (at or above 3), while Spain only features such assessments in four conditions and the Basque Country in six.

#### 4. Limitations and future lines of research

Comparing several countries presents complications, that we should take into account, such as aspects of equivalence, not only to define the data and collect them, but also in the different periods of time considered (Wood, 2009).

In addition, in terms of methodology to better understand the phenomenon of intrapreneurship, it would be interesting to use versatile research approaches and on an ongoing basis to analyse longitudinally the intrapreneurial movement within the organization.

Especially, since it is unlikely that environmental factors affect instantly the intrapreneurial behaviour of the firm, nor intrapreneurship improves the results in the very short term (Zahra, S.A., Jennings, D.F. and Kuratko, D.F., 1999).

Intrapreneurship involves long-term by definition, which requires studies of longitudinal nature.

This work is the first stage of what is expected to be further research on the effect of environmental factors on corporate entrepreneurship.

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