
Conceptualising entrepreneurship in a transition context

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Abstract: The paper sets out to review entrepreneurship in transition countries, assessing the extent to which theories and concepts of entrepreneurship developed in a market economy context can provide an appropriate interpretative framework. This is done in order to develop propositions for a model of entrepreneurship under transition conditions, which captures (1) the distinctive features of entrepreneurship, (2) the context for entrepreneurship in these countries and (3) the entrepreneurial process. The paper builds on previous papers by the authors, selectively using empirical evidence to support appropriate conceptualisation.

Keywords: entrepreneurship; Small and Medium Enterprises (SME); transition economies.

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1 Introduction

Alongside the liberalisation of prices and the creation of market institutions, the transformation of centrally planned into market economies involves the development of a privately owned business sector, through a combination of the privatisation of former state-owned companies and the creation of completely new enterprises. In principle, entrepreneurship (particularly in the form of the creation of new ventures) can contribute to the process of transforming former socialist countries into democratic, market-based systems in a variety of ways. The potential role of entrepreneurs includes generating employment, using privatised property for production, contributing to the development of a diversified economic structure, contributing to the innovative capability of the economy, and contributing to economic development through the generation of foreign sales and/or import substitution. In addition to these essentially economic roles, entrepreneurship can also contribute to the emergence and development of a middle class that is fundamental to the wider process of transformation into a market-based democracy.

However, achieving this potential contribution has presented many challenges in a context where, in most socialist countries, private business ownership was previously considered illegal; the resources for establishing and developing businesses were extremely limited and the external environment contains many institutional deficiencies, compared with most mature market economies. Not surprisingly, some 15 years after the start of the reform process, there is considerable variation between countries in the extent to which a facilitating environment for the development of entrepreneurship has been created. As a result, it is inappropriate to refer to transition countries as if they are an undifferentiated, homogeneous group, any more than so-called market economies may be considered a uniform group. Instead, it may be more appropriate to think in terms of a continuum from centrally planned economies at the one extreme to liberal market economies at the other, with individual countries situated at different points along it. In the context of former socialist economies, positioning along this continuum is heavily influenced by the extent of the commitment of government to market reforms, which is demonstrated through their actions with respect to progress with privatisation, the extent to which there is price liberalisation, and the role of government with respect to the creation and effective operation of market institutions, as well as their attitude towards entrepreneurship.

In this regard, assessment by the European Bank for Reconstruction and Development (EBRD) shows wide variation between countries with respect to dimensions, such as large- and small-scale privatisation, price liberalisation and banking reform, where the

rate of progress has typically been slower. Whilst a detailed classification of all so-called transition economies may be inappropriate here, a broad distinction can be made between Central and Eastern European Countries (CEECs) that are either current members of the EU, or in the next group to join, and former Soviet republics (other than the Baltic States). Although considerable variation can still be identified within each of these groups, such a distinction can be justified, not least because of the influence of EU accession in driving the process of institutional reform (Smallbone and Welter, 2003b).

As a consequence, when analysing entrepreneurial behaviour with the aid of concepts and theories developed in a market context, so-called transition economies cannot be treated as a single group. In practice, a growing gap can be identified between CEECs that are essentially emerging market economies and countries where the framework conditions for establishing a market environment have still to be effectively installed, particularly where there appears to be no current political will to do so (as in Belarus). For the purpose of this paper, we will use the term 'early stage transition' to describe such countries, without meaning to imply any necessary progression to later stages.

In this context, the paper sets out to review the development of entrepreneurship in countries that have emerged from central planning, in order to assess, on the one hand, the extent to which theories and concepts of entrepreneurship developed in a market economy context are appropriate for analysing this phenomenon and, on the other, the implications for existing theory of the types of entrepreneurial behaviour observed in transition conditions. This is done in order to develop propositions to subsequently feed into the development of a conceptual framework of entrepreneurship under transition conditions, which captures:

- distinctive features of entrepreneurship
- the context for entrepreneurship in these countries
- the entrepreneurial process.

One of the issues this raises concerns the nature of the evidence base on which to develop or test theories and apply concepts. In this regard, Scase (2003) refers to a lack of reliable data leading, amongst other things, to 'extremely unreliable estimates of the real significance of entrepreneurship and small business ownership in a transition context' (Vickerstaff *et al.*, 1998). However, whilst secondary data constraints, and the difficulties of systematically conducting empirical research in some of the former Soviet republics, should not be underestimated, the challenge for researchers is to develop methodological approaches that are appropriate for the context in which they are being used, as well as for the research questions they are addressing. Large-scale surveys can be undertaken in transition circumstances, and can produce potentially useful results, provided they are interpreted in the context in which the data were gathered, with the limits to generalisation clearly defined. At the same time, such methods can benefit from being used in combination with more process-oriented qualitative approaches, which on some issues can produce quite different results from those based on survey responses (Welter and Smallbone, 2003).

The empirical underpinnings of the paper comprises a number of studies since 1993, in which one or both the authors have been involved. These include studies of the survival and growth of manufacturing SMEs in Poland and the Baltic States, based on interviews with 600 businesses (Smallbone *et al.*, 1997); internationalisation and

SME development in Central and Eastern Europe in 1997–1998, which also involved a large-scale survey of SMEs in Poland, Bulgaria and the Baltic States (Smallbone *et al.*, 1999a); a study of the support needs of Small Enterprises in Ukraine, Belarus and Moldova, involving 600 interviews with entrepreneurs, as well as with providers of business support (Smallbone *et al.*, 1999b); the contribution of small businesses to regional economic development in Ukraine, Moldova and Belarus, which involved case studies, as well as a large-scale survey (Smallbone *et al.*, 2001); employment, SMEs and Labour Markets in the Russian Federation and Moldova, involving a survey of more than 1000 SMEs and case studies also (Welter *et al.*, 2000); innovation, small and medium enterprises and economic development in Ukraine and Belarus, which also combined case studies with a survey (Smallbone *et al.*, 2002); female entrepreneurship in Ukraine, Moldova and Uzbekistan (Welter *et al.*, 2003); entrepreneurial strategies and trust in low-trust and high-trust environments of East and West Europe.

2 Concepts of entrepreneurship under transition conditions

In considering concepts of entrepreneurship in a transition context, it may be helpful to briefly discuss a *number of definitional issues* that are potentially relevant. Entrepreneurship involves both inputs and outputs. Inputs involve entrepreneurial skills and qualities, with participation in the competitive process as the main output. A firm is a vehicle for transforming the personal qualities and ambitions of entrepreneurs into actions and outputs. Context may be viewed as a third dimension of entrepreneurship, since the specific internal organisational and external operating contexts provide the framework within which the input and output dimensions can take place (de Wit and Meyer, 1998).

Entrepreneurship is also a multidimensional concept that can be analysed at different levels. Firstly, entrepreneurship is concerned with individuals in terms of their roles, traits and actions, integral to which are their learning abilities and behaviours (Pedler *et al.*, 1998). Individual entrepreneurs can operate on their own or in teams. The second dimension is at the firm level, and the third at the aggregate level of industries, regions and nations. A consideration of the role and characteristics of entrepreneurship in a transition context involves linking the individual level to the aggregate level, as the context for entrepreneurship is a distinctive one, with a much stronger influence on entrepreneurship compared to mature market economies (cf. Section 3). Moreover, in any context, entrepreneurial learning activities need to be analysed as a reciprocal process between an individual entrepreneur/firm and the external environment, with the entrepreneur and his/her environment interacting and influencing each other (Berger and Luckmann, 1967).

Scase (1997; 2003,p.67) has contributed to the debate about the role of entrepreneurship under transition conditions by distinguishing between entrepreneurship and proprietorship, based on ‘contrasting psychologies of business founders; their attitudes towards trading; and their orientation towards capital accumulation’. According to him, entrepreneurship refers to a person’s commitment to capital accumulation and business growth, whereas proprietorship describes the ownership of property and other assets, which may be used for trading purposes to realise profits, but which are not utilised for longer term purposes of capital accumulation. Any surpluses generated by proprietors are likely to be consumed rather than reinvested for business purposes.

In the pursuit of capital accumulation and long-term growth, the entrepreneur may forego personal consumption and may actively search out market opportunities, which involves taking risks and coping with uncertainty. In the case of proprietorship, according to Scase, the motives are quite different, since surpluses are not reinvested in the business for future long-term capital accumulation but rather consumed and used to sustain a specific standard of living. According to Scase, in the transitional economies of Russia and Central Europe, proprietorship rather than entrepreneurship best describes the majority of small business activity. His assessment is that whilst numerically significant, particularly in sectors such as services and retailing, offering employment and providing earnings, these proprietors are incapable of constituting an indigenous force for economic development at the macrolevel.

Although Scase focuses on transition economies, his distinction between entrepreneurs and proprietors is not specific to a transition context. The lack of commitment to long-term capital accumulation, with an emphasis on consuming any surplus rather than reinvesting it in the business (proprietors, according to Scase), is a common feature of many small firm owners in mature market economies. It is one of the reasons why few small businesses grow to any great extent. Perhaps the issue needs to be viewed as part of a wider discussion about the role of entrepreneurship and small business in economic development, rather than being viewed as a specifically transition issue. In this context, the key point to emphasise is the importance of Schumpeterian-type entrepreneurs to economic development in any economy and the creation of 'newness', such as in terms of products and processes. However, as Wennekens and Thurik (1999) note, in practice, few business owners are either pure Schumpeterians or pure 'shopkeepers'.

Scase's approach is related to an earlier concept developed by Bögenhold (1987), who distinguished between entrepreneurship motivated by economic needs and entrepreneurship that is driven by a desire for self-realisation. More recently, the Global Entrepreneurship Monitor (GEM) consortium has distinguished between 'opportunity' and 'necessity' entrepreneurship, based on the reasons given by entrepreneurs for starting a new business, with necessity entrepreneurship tending to dominate in transition and developing countries.

However, some empirical results have challenged the appropriateness of such a simple dichotomy. For example, it has been suggested that concepts of 'necessity' and 'opportunity' entrepreneurship are overly simplistic classifications, especially in the context of the conditions pertaining during early stages of transition, where the use of such terminology may lead to overly negative conclusions about the contribution of entrepreneurs (Smallbone and Welter, 2003a). This is partly explained by the specificities of external conditions that can lead to even well-educated people being presented with limited opportunities for satisfying and sufficiently rewarding employment, which contributes to entrepreneurship attracting individuals with high levels of human capital. As a result, many entrepreneurs in transition environments are well equipped to identify and exploit opportunities as they emerge over time, even if the initial reasons for becoming an entrepreneur in the first place can reasonably be described as 'necessity'. It is also influenced by the learning experience of individuals, which can contribute, over time, to changes in their motivation and behaviour with respect to entrepreneurship. Even in those post-socialist countries where institutional and other external conditions for private entrepreneurship are deficient, entrepreneurs set up businesses for a variety of reasons, including 'pull' as well as 'push' factors. Moreover, the aims and orientation

of entrepreneurs can change over time, as new opportunities are presented, the business environment improves and/or because of the development of their own entrepreneurial capacity.

Concepts such as proprietorship/entrepreneurship and the distinction between opportunity- and necessity-driven entrepreneurship implicitly focuses on the attributes of individuals, which can be measured through, for example, the motives and objectives of entrepreneurs, or, as Scase emphasises, through 'psychological profiles'. This draws on the psychological traits approach, which has been widely criticised for its restrictive focus on entrepreneurship as a personal phenomenon, divorced from its social and institutional context.

New venture creation must be viewed as a process, which means that the aims and motivations of (potential) entrepreneurs can operate at different levels, taking into account deep-seated antecedent influences as well as immediate triggers. The entrepreneurship literature contains numerous models and frameworks developed to analyse the process of starting a business, most of which have been based on research undertaken in market economies. In the context of a transition environment, such frameworks are potentially useful for analysing the barriers faced by entrepreneurs and potential entrepreneurs, since it is likely that these barriers will vary at different stages of market development. At the same time, the distinctiveness of transition conditions raises the question of whether these models can fully capture the entrepreneurial process in post-socialist countries.

One issue that arises in countries that until ten years ago were operating under a centrally planned system concerns the potential of entrepreneurial activities during the socialist period to 'breed capitalism' (Kornai, 1992). If so, they may act as the 'antecedent influences', identified by authors such as Cooper (1981), which have potential implications for the balance between productive and unproductive entrepreneurship (Baumol, 1990). Although in Central and Eastern European countries private entrepreneurship lost its major role with the introduction of a centrally planned economic system, different forms of private entrepreneurship coexisted beside state ownership and entrepreneurship within state enterprises during the socialist period. In this regard, we can distinguish between the formal and the grey economy, where 'boundaries' frequently changed following political trends of liberalising and restricting private ownership and entrepreneurship.

In addition, Rehn and Taalas (2004) have emphasised how entrepreneurship flourished during the Soviet period in the daily lives of individuals, as they struggled to cope with the material shortages that were a common occurrence in the Soviet system. In pointing out the importance of interpreting entrepreneurship in its specific social context, Rehn and Taalas raise definitional issues concerning the nature of entrepreneurship, which they interpret as a 'search for opportunities and beneficial outcomes in economic interactions' (Rehn and Taalas, 2004, p.246) which, through necessity, made most citizens of the USSR Entrepreneurial, in the Rehn and Taalas sense.

All this contributes to a different background of entrepreneurs in transition conditions, which interacts with characteristics of the institutional environment to influence the specific patterns of their entrepreneurial behaviour. For example, in early-stage transition countries, where progress with market reforms has been slow or stalled, we can frequently observe a persistent type of behaviour that may be characterised as 'muddling through' and 'rule avoiding', but which nevertheless represents a learned response to a particular set of external environmental conditions

(Welter and Smallbone, 2003). Examples include economic activity that is at least partly in the shadow economy, tax evasion and a heavy reliance on personal network contacts in daily business life.

Principally, entrepreneurs fall back on behaviour they have previously applied successfully, as long as they are facing familiar situations, for which 'closed-loop' learning can provide the basis for making an adequate response. However, faced with unpredictable or even unknowable change situations, tried and tested routines may be inadequate. An example relates to the rapid series of changes in and instability of macro and institutional conditions at the beginning of the transition process. Although this situation would require a change in entrepreneurial behaviour, cognitive biases inherent in decision-making processes could reinforce a muddling-through approach and the unstructured behaviour of entrepreneurs. The conflict theory of decision-making explains this in terms of 'avoidance' (Lyles and Thomas, 1988). Once an entrepreneur has settled on a particular course of action, (s)he will change his/her behaviour only in cases where current actions lead to negative results, which are higher than the risk associated with taking an unknown course of action.

3 The institutional embeddedness of entrepreneurship in a transition context

In a transition context, the environment is characterised by a high level of uncertainty, rapidly changing external conditions and institutional deficiencies, which result in significant additional operating costs for businesses without contributing any additional value (Smallbone and Welter, 2001b). The key question is whether or not this results in fundamental differences in the way that entrepreneurs identify and exploit opportunities, compared with their counterparts in mature market economies, and/or whether the outcomes, for example, in terms of the types of organisation established, are distinctive. Although much of the research on entrepreneurship in transition economies has focused on entrepreneurs and their behaviours at an individual level, the specific characteristics of the external environment under transition make the latter a potentially more dominant influence on entrepreneurship than in a mature market context, where external conditions are typically more stable.

So far, with the exception of the eclectic approach to entrepreneurship (Verheul *et al.*, 2002), most entrepreneurship theories focus on microlevel influences in order to explain new venture creation and the development of entrepreneurship, taking the institutional environment as given. However, there is considerable empirical evidence from transition economies that shows the external environment to be one of the dominant features influencing the nature and pace of entrepreneurship (*e.g.*, Peng and Heath, 1996; Peng, 2000; Polishchuk, 2001; Smallbone and Welter, 2001a–b). It can be argued that in any context, enterprise behaviour results from a dynamic interrelationship between internal (*i.e.*, both organisational and personal characteristics) and external conditions, but in situations where market conditions are only partially installed, the institutional context becomes a critical factor. Referring back to the introduction, where a continuum of market development was described, if entrepreneurship is viewed as an individual act, undertaken in specific social/institutional/environmental conditions, then the balance between individual and environmental factors in explaining entrepreneurial behaviour is likely to vary at different points along that continuum.

In this context, an institutional perspective can be used to explore differences in the embeddedness of entrepreneurship in post-socialist and market-economy environments and the influence on entrepreneurial processes. Institutions represent the 'formal' and 'informal' constraining and enabling forces with respect to entrepreneurship, creating opportunity fields (*e.g.*, through laws) and influencing the collective and individual perception of entrepreneurial opportunities. Nooteboom (2002,p.34) defines institutions as 'things that constrain, enable and guide behaviour', consequently discussing a separation between so-called surface institutions, which would enable and constrain, and deep structures, which would guide individual behaviour. However, Nooteboom himself concludes that a clear separation is not viable owing to recursive and feedback links between both concepts, illustrating the difficulties in achieving a clear-cut distinction between formal and informal institutions.

One prominent example of formal or regulatory institutions is laws, which might create new opportunity fields for entrepreneurs, as happened in transition economies with the introduction of property rights allowing for private ownership. On the other hand, a deficient legal infrastructure (*e.g.*, implementation gaps, a lack of judges, economic courts) could restrict entrepreneurship, especially where an 'institutional void' (Polishchuk, 2001) allows for discretionary actions of administration, thus fostering rent seeking, corruption and noncompliant or defiant behaviour of entrepreneurs. Normative and cultural-cognitive elements contain the collective sense making and individual understanding of societal values and rules, respectively, which depend on previous experiences and knowledge.

The nature and extent of entrepreneurship across different environments reflects particular settings of institutions and enforcement mechanisms (Scott, 2001; Honig and Karlsson, 2004). Formal institutions are enforced by coercive mechanisms as mainly set down in government rules, whilst informal institutions are enforced by normative and mimetic mechanisms. Normative mechanisms push entrepreneurs to follow codes of behaviour as set out by a specific community, such as industries, business associations, families or ethnic groups. They assist in creating legitimacy, which is of particular importance for nascent entrepreneurs and entrepreneurs in environments such as the transition context, where they face the additional degree of liability of newness. Formal mechanisms to ensure normative behaviour include regulations, such as licensing, registration or accreditation (Scott, 2001), while informal institutions are also enforced by trust (Welter, 2003b; Welter *et al.*, 2004).

Normative pressures, as codified in informal institutions, regulate entrepreneurs' behaviour and restrict their options, thus often forcing entrepreneurs to comply, even when they have to employ illegal actions. One such example is the Russian tax system. When paying taxes, entrepreneurs face a bundle of unwritten rules, such as bargaining over the law, making friends within the tax authority, observing the formalities (*e.g.*, filling in fictitious statements) and knowing their limits, which applies to both taxpayers and inspectors (Busse, 2002). Again, these institutions are partly founded on Soviet predispositions, where the individual bureaucrat was the ultimate decision-making authority, rather than a law or written regulation itself (Busse, 2002,p.215), although they also result from regulatory shortcomings and gaps in implementing the new institutional frame.

In a transition context, several studies have confirmed the occurrence and persistence of avoidance behaviour (*e.g.*, Frye and Shleifer, 1997; Hendley *et al.*, 2000; Gustafson, 1999), which can be explained by a highly volatile institutional environment,

encouraging entrepreneurs to fall back on learned behaviour. Feige (1997,p.28) characterises such actions as the 'legacy of non-compliance', which dominated most of the tolerated and nonlegal entrepreneurial activities in Soviet times. Other examples of entrepreneurial behaviour reflecting a response to specific institutional conditions include a high degree of networking, based on personal connections, particular financial bootstrapping tactics, and diversification or portfolio entrepreneurship (Welter and Smallbone, 2003). With regard to networking, entrepreneurs draw on behaviour, which was widely used during Soviet times, namely reciprocal favours ('blat'). During the Soviet period, 'blat' was an integral part of the everyday lives of Soviet citizens, providing a mechanism for 'realising the hidden potentials of the system' (Ledeneva, 1998). Such behaviour represents an integral part of the inheritance of citizens in transition countries, originating from the Soviet period, and one of the mechanisms for dealing with resource constraints facing entrepreneurs during the transition period.

Another enterprise reaction to the external environment in transition economies concerns the so-called financial strategies of SMEs, in a situation where access to finance from formal sources is extremely scarce. Here, financial bootstrapping is used, including, for example, serial entrepreneurship as one way for SMEs to accumulate the financial resources necessary to start a business, in a context where the financial system is inadequate (Smallbone and Welter, 2001a). This often is extended to portfolio entrepreneurship and diversification, particularly in sectors such as manufacturing, where access to external capital is scarce and demand may be fluctuating and uncertain. The establishment of a retail shop or market stall by a clothing manufacturer is one example. In a transition context, such behaviour does not only reflect the 'normal' risk behaviour of entrepreneurs, but can also be encouraged by certain institutional deficiencies. For example, diversification commonly represents a deliberate strategy of making business success less visible to officials and those who may seek to make money from offering 'protection'. Although our evidence from several projects also implies that motives for diversification strategies include the realisation of market opportunities, as well as ongoing access to markets, the role of both portfolio entrepreneurship and product diversification as a means of overcoming (short-term) financial constraints is even more important, especially with respect to enterprises with high investment and working capital needs.

In addition, case studies show that diversification in such conditions often results in a broad and apparently unrelated portfolio of activities. Thus diversification strategies of enterprises in a transition context, particularly in early-stage countries, do not mainly reflect long-term strategic considerations. They chiefly express short-term behaviour to overcome financial and environmental constraints and institutional deficiencies. This emphasis on behaviour driven by short-term expediency, which is necessary for a business to continue to operate, is also reflected in the reported pattern of the use of advice and assistance from external sources, which in early-stage transition environments is typically focused on the use of legal and tax consultants, rather than on help (*e.g.*, with marketing) associated with improving the basis for longer-term business development (Smallbone *et al.*, 2001).

Although such behaviour may fall short of the optimal, standard set of 'economic man' assumptions, it may be viewed as a rational entrepreneurial reaction to the given institutional framework. In adverse, unfamiliar and fragile environments, entrepreneurs keep a low profile, mainly avoiding official regulations whenever possible, or attempting to conform, which is made difficult in environments with rapid institutional changes.

Thus, environments with institutional gaps generally favour a muddling-through type of behaviour (Barrett, 1998). New and unfamiliar environments lack the basic strategic options, which have to be tested and learned in a trial-and-error manner, going from simple to more complex patterns over time (Welter, 2003a). In fragile and turbulent environments, entrepreneurs have to decide and (re-) act rapidly, whilst the deficient institutional settings re-enforce institutional mistrust.

In this regard, the concept of path dependency helps to explain rule avoiding and seemingly sub-optimal behaviour. Conflicting formal and informal institutions encourage individuals to recur to familiar courses of action. If successful, this tends to reinforce trusted and known codes of conduct, resulting at the individual level in an 'escalating commitment' of entrepreneurs to viable, but not necessarily the best, courses of actions (Whyte, 1986). This in turn further constrains the required adaptation of informal institutions, often resulting in vicious circles and low-level efficiency traps for entrepreneurial behaviour, which are a widespread phenomenon in transition economies, especially in the early phases of transition (Kuznetsov, 1997).

From an economic point of view, these 'lock-in effects' foster sub-optimal resource allocation, resulting in unproductive entrepreneurship, as described by Baumol (1990). In such situations, entrepreneurship remains restricted, the number of firms small and their contribution to economic development in terms of jobs, innovation and external income generation rather limited. As a result, institutional change becomes an important resource needed to initiate entrepreneurship, particularly in uncertain and unstable contexts. Institutional change positively influences entrepreneurship when it removes or lowers barriers to market entry and market exit, thus creating opportunity fields for entrepreneurs, and vice versa. Examples of positive institutional changes include the introduction of private property rights at the beginning of the transformation process in some former socialist countries, or efforts to reduce regulatory burdens on enterprise in mature market economies.

4 The entrepreneurial process under transition conditions

One of the contemporary themes in the mainstream entrepreneurship literature is concerned with the creation and identification of entrepreneurial opportunities, which raises the question of whether the entrepreneurial process differs in a transition environment, differs from that in a mature market context and if so, in what aspects. In this context, some of the most recent models of the entrepreneurial process concentrate on opportunity recognition as an important element. For example, Beattie (1999) identifies two major models of the business creation process, differentiated by factors that influence opportunity recognition. The first incorporates individual characteristics and environmental influences, understanding venture creation as an interactive process in which a person, his/her personality and interpretation of events influence any decision to start a business. Theoretically, this process is reflected, for example, in Shapero's concept of the entrepreneurial event, or Ajzen's theory of planned behaviour, which interprets entrepreneurial intentions as a function of feasibility and desirability.

The second model, of which Gibb and Ritchie's (1982) approach is an example, accepts venture creation as an outcome of the situations encountered and the social embeddedness of the entrepreneurs, thus implicitly picking up the theme of opportunity enactment outlined below. In this context, Kirzner's understanding of opportunities

as a result of entrepreneurial alertness, entrepreneurial beliefs and information asymmetries (Kirzner, 1997a–b) emphasises the cognitive properties of (potential) entrepreneurs, which have an impact on entry patterns into entrepreneurship as well as subsequent development paths, thus indirectly influencing the extent and nature of entrepreneurship.

Shane (2003) distinguishes between two types of opportunities, *i.e.*, Schumpeterian and Kirznerian ones. Schumpeterian opportunities result from disequilibrating situations, which makes them rare and innovative, involving the creation of new combinations. Sources of Schumpeterian opportunities include technological changes, political and regulatory changes and social and demographic changes. Compared to these, Kirznerian opportunities are understood as being equilibrating, not requiring new information, less innovative, common and having a limited potential for discovery and innovation (Shane and Venkataraman, 2000; Shane, 2003).

Schumpeter's understanding of opportunities draws attention to environmental influences. This allows us to construct a link between the embeddedness perspective of entrepreneurship and an individual perspective, as the institutional framework influences the existence of opportunities as well as their recognition and possibilities for exploitation, which is explicitly recognised by Kirzner (1980) also. In this context, Shane (2003, pp.22–33) and Eckhardt and Shane (2003, pp.341–343) review empirical evidence for opportunity creation, resulting from what they label 'exogenous shifts in information'. Several studies confirm that changes in technology, political forces, regulation and macroeconomic influences, as well as social trends, are decisive influences on the existence and occurrence of new opportunities. All these apply to transition economies, which underwent fundamental changes when the process of transformation from a central planned economy towards a market-based system began.

In a transition context, the Kirzner type of opportunities would be more apparent in later stages of transition, where markets have been developed and flows of information, ideas and knowledge from mature market economies represent an important source of innovation for enterprises (Smallbone *et al.*, 2002). It is reflected in empirical surveys in more advanced transition countries, where entrepreneurs complain about growing competition as one of their pressing business problems (*e.g.*, Smallbone *et al.*, 1999b; Smallbone and Welter, 2003b). By contrast, in early-stage transition countries it is the lack of resources needed to realise an entrepreneur's business idea, together with a lack of institutional stability and unpredictability of institutional behaviour, that is emphasised (*e.g.*, Smallbone *et al.*, 2002; Welter *et al.*, 2003). At the beginning of the transition period, limited competition existed in many markets and market opportunities resulted from the shortages of certain goods for which a latent demand existed. Such an environment was potentially a 'seedbed' for the Schumpeterian type of opportunities for entrepreneurs, although a variety of institutional constraints limited their ability to exploit these.

The embeddedness of opportunities in the formal institutional environment may be illustrated with reference to the initial changes in the institutional framework that fostered entrepreneurship, when legal and administrative reforms made it legally possible for privately owned businesses to compete with state-owned enterprises. Consequently, the number of private firms increased sharply in what has been described in Poland, for example, as 'an explosion of entrepreneurship', facilitated by a removal of legal barriers to market entry, combined with the low intensity of competition and the existence of opportunities to earn monopoly profits and/or speculative incomes for a

period (Piasecki and Rogut, 1993). In explaining this, McMillan and Woodruff (2002) emphasise the results of distortions created by the planned economy, which created new market opportunities for potential entrepreneurs (*e.g.*, in consumer services), once the establishment of privately owned enterprises became legal. However, in situations where a new formal framework is not (yet) properly implemented, ‘loopholes’ for ‘creative’ entrepreneurial activities may be created, although some of these may fall into the category of unproductive or even destructive entrepreneurship, as described by Baumol (1990).

Whilst focusing on the effects of the institutional environment on the exploitation of opportunities, Shane (2003, p.160) recognises, in principle at least, that the former may also influence the discovery of opportunities. An example of institutional deficiencies creating opportunities for entrepreneurship is the development of business service consultancies in Ukraine, which is a new and emerging sector in such a context (Smallbone *et al.*, 2002). The customers of these small consultancy firms are mainly private businesses, but also include some state and municipally owned enterprises, which are increasingly looking for firms to supply a full range of services to avoid the necessity of employing several specialist companies. This ‘full service’ portfolio would include not just business advice, but also the acquisition of the necessary licences and permits needed to start and run an enterprise or, in some cases, to develop a new project. The consultancy firms that had developed to fill this niche were not ‘grey sector’ enterprises, but some of the most innovative and successful service firms in the study, which had responded positively to a market opportunity created by the specific institutional conditions pertaining to Ukraine at the time. Whilst the specific nature of the opportunities may be transient, as the institutional environment for productive entrepreneurship improves, the behaviour demonstrated by these enterprises shows a high level of sensitivity and responsiveness to the needs of customers, who are also heavily influenced by institutional conditions.

Whilst Schumpeter puts more emphasis on the ‘objective’ side of opportunities and the related process of discovering and exploiting them, which he describes as a process of creative destruction, Kirzner (1997a, p.51) implicitly understands this as an enacted phenomenon: “Entrepreneurial discovery represents the alert becoming aware of what has been overlooked. When the human agent acts, he is determining what indeed he ‘sees’ in the murky future”. In this context, Kirzner (1979; 1997b) also refers to spontaneous learning and ‘surprise’ as a fundamental basis for entrepreneurial discoveries, allowing the inclusion of ‘serendipity’ and ‘luck’ as possible sources for entrepreneurial actions. A Kirznerian perspective draws attention to the interplay of ideas, beliefs and actions in defining and creating opportunities defying a simplistic view (Sarasvathy *et al.*, 2003). Opportunities do not only ‘exist out there’, they are also created (Davidsson, 2003). Opportunities emerge as individuals make sense of information and their actions, thus retrospectively ‘discovering’ and ‘recognising’ opportunities (Gartner *et al.*, 2003).

As Gartner *et al.* (2003) argue, this opportunity enactment perspective draws attention to the fact that environments are also influenced by the scope of individual actions, which draws attention to the recursive links existing between individual perceptions and environments, both simultaneously creating opportunities. This brings us back to the institutional embeddedness perspective on entrepreneurship outlined in Section 3 above, which can be integrated into our discussion on opportunities in a transition context. Whilst formal institutions create opportunity fields for entrepreneurship, informal institutions influence the collective and individual perception of entrepreneurial

opportunities, thus resulting in differences in the opportunity recognition process across contexts, cultures and countries. In a transition environment, this concept takes on particular importance, because the environment in which opportunities are created is qualitatively different compared to market economies, and conditions can also change very quickly.

5 Conclusions and implications

Davidsson (2003) has emphasised the need for entrepreneurship research to acknowledge the heterogeneity of environmental conditions, outcomes and behaviours. The key question, as far as this paper is concerned, is the extent to which existing concepts and theories are appropriate bases for analysing entrepreneurship in transition conditions. The discussion shows that entrepreneurship in a transition context is not unique, as the essential principles of individual behaviour are the same regardless of the environment. However, where the process of entrepreneurship is distinctive is with respect to the specific interplay between individual entrepreneur/firm behaviour and the external environment, which changes as the process of transition unfolds. This emphasises the need to carefully review theories and concepts based on market economy principles for their usefulness and applicability in a context where market conditions are only partially established.

In this context, our selective review of literature and the empirical evidence base leads us to suggest a number of key propositions:

- In assessing the relevance of concepts and theories of entrepreneurship, developed in market economies, to transition environments, it is important to recognise the distinction between countries where the process of market reform is advanced, such that they may be better described as emerging market economies, on the one hand, and countries where the framework conditions for a market economy are still to be installed, on the other. In the latter case, external conditions may encourage unproductive, and even destructive, forms of entrepreneurship, with implications for its contribution to economic development.
- As in mature market economies, the nature and extent of entrepreneurship in a transition context depends on individual goals and self-perceptions of the entrepreneur with regard to opportunities for venture creation and development, as these influence the steps entrepreneurs take to set up and/or expand their venture. All are influenced by the values and conventions within a society, as well as by the background of entrepreneurs, who for the most part have no prior experience of entrepreneurial activity in a market context, but are often educationally well qualified, with some experience of management.
- The institutional environment influences the extent to which entrepreneurship develops, but also the forms that entrepreneurship takes and the behaviour patterns exhibited by entrepreneurs. In environments where institutional settings are not clearly defined, as in 'early-stage' transition countries, (nascent) entrepreneurs face a high level of uncertainty and ambiguity. This results in entrepreneurs falling back on learned behaviour, such as networking and avoidance strategies, which are to some extent path dependent. Although such behaviour might support firm performance

and/or survival in the short run, it might be detrimental to firm development and growth in the long run.

- Typologies which crudely classify individuals as entrepreneurs or proprietors, or necessity- or opportunity-driven, fail to recognise the learning capability of individuals, who are interacting with a rapidly changing external environment. Whilst the point applies to entrepreneurship in all types of external conditions, it is a particular issue in transition economies, because of the reported dearth of opportunity-driven entrepreneurs.
- Institutional change can create opportunities for entrepreneurship, as it opens up new fields which entrepreneurs can pursue. However, institutional change may also trigger and/or reinforce norm-deviant behaviour at the individual level. Conflicts within the institutional settings may encourage entrepreneurs to revert to familiar and known courses of action (learned behaviour), based on the requirements of a previous institutional environment, thus fostering 'lock-in' situations where path dependency prevents entrepreneurs from adapting to new context conditions.
- Fostering entrepreneurship in 'locked-in' situations, where institutional change is needed, requires entrepreneurial (re-) learning. Institutional change itself may trigger entrepreneurial learning, but the learning capability of entrepreneurs and businesses influences the nature of the response.
- Entrepreneurial opportunities in a transition context differ across the various stages of transition being linked to the institutional environment. In early stages where a new institutional framework is in the process of being created, Schumpeterian opportunities result from disequilibrating situations. Kirzner-type opportunities (equilibrating, less innovative) would be more apparent in later stages of transition, where markets and business environments have been developed and are more stable, thus forcing nascent entrepreneurs more and more into imitative new ventures.

The implications for further research on entrepreneurship (in a transition context) emphasises the importance of viewing entrepreneurship as a learning process, where entrepreneurs change their behaviour in reaction to changes in their external environment, or in anticipation of this. In this perspective, entrepreneurship is understood as a nonlinear process with feedback loops between individuals and their environment. This draws attention not only to the individual component of entrepreneurship, but also to its institutional embeddedness. This emphasises the need for caution when applying entrepreneurship theories and concepts, which have been elaborated in the context of a mature market economy, to explain the entrepreneurship phenomenon in situations where the framework conditions for a market economies are still to be established.

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