

International Studies in Entrepreneurship

Mark Sanders

Axel Marx

Mikael Stenkula *Editors*

The Entrepreneurial Society

A Reform Strategy for Italy, Germany
and the UK



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Chapter 4

On the Institutional Foundations of the Varieties of Entrepreneurship in Europe



Andrea M. Herrmann

Abstract For decades, research into the link between national institutions and entrepreneurship has been characterized by three shortcomings: First, clear-cut concepts of institutions are rare. Second, a parsimonious understanding of how a few core institutions influence entrepreneurship is missing. Third, scholars often ignore that incrementally innovative ventures constitute a distinct (and under-researched) type of entrepreneurship next to the (over-researched) form of radically innovative, high-growth or high-tech entrepreneurship. This chapter seeks to illustrate how the application of the “Varieties-of-Capitalism” (VoC) reasoning does not only enable focused rather than eclectic analyses of institutional influences on entrepreneurship but also reveals the institutionally induced equifinality of the varieties of entrepreneurship across Europe. These insights invite future entrepreneurship research to move away from the ideology that displays radically innovative entrepreneurship as, by far, the most desirable form of entrepreneurship. This finding also invites policymakers to target entrepreneurial support measures more specifically to their economy’s institutional environment.

Keywords Entrepreneurship · Varieties-of-Capitalism · National institutions · Institutional complementarities

This chapter summarizes some of the core findings of Work Package 5 of the FIRES research project (<https://projectfires.eu>), which received funding from the European Union’s Horizon 2020 research and innovation program under grant agreement No 649378. The theoretical foundations for this work package published earlier in Herrmann (2019) were reiterated—largely verbatim—in Sects. 4.1 and 4.2. While Sects. 4.1 and 4.2 are therefore no original work, the remainder of the chapter is original work to the extent that it provides a systematic overview over how this argument is based on a set of papers that have been published or are under review, in (Dilli et al. 2018; Held et al. 2018; Held et al. 2018a, b; Held 2019). I thank Selin Dilli for comments on earlier drafts of this chapter.

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4.1 Introduction

Over the past two decades, the Varieties-of-Capitalism (VoC) literature, going back to the work of Hall and Soskice (2001a), has become a widely applied framework in the political sciences, in political economy and economic sociology alike. In a nutshell, the VoC literature illustrates that different national institutions governing labor and financial markets as well as inter-organizational collaborations facilitate different types of corporate innovation. While the VoC framework has been developed mostly through studies of incumbent firms, its reasoning is also applicable to new ventures. National institutions are likely to lead also new ventures to develop business ideas of different innovativeness. To put it differently, given that incumbent firms were found to compete on different types of innovations and thus, in different market segments between countries, it is reasonable to assume that many firms have chosen these competitive strategies from their inception as new ventures.

However, until the beginning of the H2020 project *Financial and Institutional Reforms for an Entrepreneurial Society in Europe* (FIRES), the VoC framework has hardly been applied in entrepreneurship research (for exceptions, see Ebner 2010; van der Walt 2010).¹ To be clear, the entrepreneurship literature illustrates that entrepreneurs are driven by different motives and reasons, and have diverse aspirations and growth ambitions (for example, Cooper and Artz 1995; Wiklund et al. 2003). Accordingly, the literature acknowledges that different forms of entrepreneurship exist, ranging from solo self-employment over small family businesses to high-growth gazelle ventures (see also Delmar et al. 2003; Henrekson and Stenkula 2016; Vivarelli 2013). The Global Entrepreneurship Monitor, by far the most comprehensive dataset on entrepreneurship forms across the world, also shows that entrepreneurship takes different forms between countries. However, systematic research into institutional reasons, as laid out by the VoC literature, for how and why entrepreneurship between countries may differ in its innovation focus remained underdeveloped until the start of the FIRES project.

This research gap has arguably (see Herrmann 2019) persisted because of a strong focus on radically innovative—that is “technology-intensive” (OECD 1998), “R&D-intensive” (Schreyer 2000), or “knowledge-intensive” (Delmar et al. 2003)—ventures. This focus can be theoretically motivated by their high-growth potential and empirically because these ventures have been shown to generate a disproportionately high share of employment (see also Amat and Perramon 2010; Davidson and Segerstrom 1998; Hözl 2009; OECD 2002; Shane 2009). Radically innovative ventures typically develop goods and services based on new technologies, leading to strong corporate growth on the one hand and a higher risk of failure on the other. Examples of such radically innovative ventures have emerged particularly frequently in Silicon Valley which, in turn, has led to an idolization of this radically innovative,

¹The reason why the VoC framework has hardly been applied in business and management research today seems straightforward: The core proponents of the VoC arguments, as well as their followers, are political scientists (Peter Hall, Kathleen Thelen), political economists (David Soskice), and sociologists (Wolfgang Streeck) rather than business and management scholars.

“Silicon Valley” entrepreneurship. Newspapers have reported with high frequency about the heroic efforts and outstanding success of Silicon Valley entrepreneurs, and even mainstream movies have been made about the start-up stories of Apple and Facebook. Because attention and impact have accrued to studies of extraordinary rather than every-day phenomena, scientific research has paid inordinate attention to the funding and other needs, along with the impact of radically innovative ventures (see, for example, Henrekson and Johansson 2010; Shane 2009). And as a consequence, policymakers across Europe explicitly or implicitly aim to facilitate high-growth (“Silicon Valley”) entrepreneurship (Commission 2010; OECD 2002; see also Hölzl 2009; Mason and Brown 2013).

This focus on radically innovative entrepreneurship is problematic for various reasons. First, it conveys the impression that less innovative types of entrepreneurship are second-best as they grow less rapidly (see, for example, Amat and Perramon 2010; Davidson and Segerstrom 1998; Hölzl 2009; OECD 1998, 2002; Schreyer 2000). This reasoning is flawed as recent studies show that high employment growth is not only generated by highly innovative start-ups but also by more established firms of at least five years (Anyadike-Danes et al. 2009) and with an average age of 25 years (Acs et al. 2008a). Furthermore, a recent study of the German ministry of economic affairs finds that “high-growth ventures can also shrink again as well. A high-growth venture (...) is thus no guarantee for sustained employment growth but constitutes a temporary phenomenon” (BMW 2012, p. 42; see also Daunfeldt and Halvarsson 2015). Second, the focus on radically innovative entrepreneurship is also problematic because it neglects the comparative institutional advantages that continental European economies offer to incrementally innovative start-up firms. As laid out in detail below, the institutional environment of regulated economies makes it easier for entrepreneurs to establish incrementally rather than radically innovative ventures. Third, incrementally innovative ventures grow at a lower but more sustainable rate than their radically innovative counterparts (Herrmann 2008, Chap. 5). If successful, radically innovative ventures typically yield higher returns than incrementally innovative ventures. But the chances of becoming successful are decisively lower for radically than for incrementally innovative ventures. Last but not least, radically innovative ventures occur much less frequently than their incrementally innovative counterparts, even in the USA. While most new ventures are not innovative across economies, among those that are, incremental innovation is the rule and radical innovation is the exception (see Baumol 2002, 2004; Henrekson and Sanadaji 2014, p. 1760; Nightingale and Coad 2014).

In several studies, whose most important results are reported in Sect. 4.3 of this chapter, we show how a core set of distinct national institutions facilitates the development of different types of entrepreneurial innovation across Europe. These studies do not only explain why radically innovative ventures develop more frequently in Anglo-Saxon economies. They also illustrate why incrementally innovative ventures are more common in Northern Europe, while new ventures reproducing goods and services at lower costs are particularly frequent in Southern and Eastern European economies. Importantly, the insights gained from these studies may motivate future research to move away from its focus on radically innovative entrepreneurship as

the most desirable entrepreneurship type. Overall, the studies below (see Sect. 4.3) thus illustrate how a better understanding of the varieties of entrepreneurship in Europe can lead to a more balanced understanding of the possibilities and needs—or rather the difficulties and needless efforts—to equally foster radically innovative entrepreneurship in Continental Europe.

To illustrate how the VoC reasoning offers a more balanced understanding of the link between distinct national institutions and different types of entrepreneurial innovativeness, I first review the core arguments of the VoC literature on a country's institutional foundations in Sect. 4.2. Section 4.3 then provides an overview of four FIRES studies that show how different institutional frameworks induce different types of entrepreneurial venturing across Europe. Section 4.4 illustrates the implications that result for researchers and policymakers from these findings.

4.2 Theoretical Foundations

Importantly, the VoC arguments on how a distinct set of institutions support different types of corporate innovativeness have, until the start of the FIRES project, been empirically tested on the basis of *incumbent firms* (Hall and Soskice 2001a; Hancké et al. 2007; Casper 2007; Herrmann 2008). We therefore begin with the question of whether these arguments are equally applicable to *nascent ventures*. To answer this question, we first develop a theoretical framework that could explain which institutions are core to the development of (different types of) entrepreneurship, and why.

Starting with the work of Stinchcombe (1965), the entrepreneurship literature investigating how institutions influence entrepreneurship gained momentum in the early 1990s. Its contributors arrived at the conclusion that institutions “matter” because they structure economic payoffs which influence entrepreneurial efforts and activities (Calcagno and Sobel 2014; Baumol 1990; Murphy et al. 1990; Sobel 2008). While the literature agrees that both formal and informal institutions incentivize individual behavior (North 1990), thereby influencing the extent and character of an economy's entrepreneurial activity (Acs et al. 2008b; Stenholm et al. 2013; Urbano and Alvarez 2014), it also—often implicitly—focuses on the institutional drivers of *radically innovative entrepreneurship*. The formal institutions were found to be beneficial for “productive,” “high-growth” entrepreneurship and include law and order, contract enforcement, competition policy, trade policies, tax codes, social insurance systems, employment protection legislation, capital market regulation, as well as the protection of private property (Bjørnskov and Foss 2013; Hall and Jones 1999; Henrekson and Johansson 2009). Informal institutions supporting growth-oriented entrepreneurship include individualism, social capital, trust, and power distance (Hechavarria and Reynolds 2009; Taylor and Wilson 2012). In short, the literature suggests that differences in entrepreneurship between countries or regions can, *inter alia*, be explained by a broad diversity of institutions (Case and Harris 2012; Stam 2014; World Economic Forum 2013).

This literature on institutions and entrepreneurship suffers from three problems. First, a clear-cut concept of institutions is missing. Second, a parsimonious understanding of whether and how a few core institutions facilitate different types of entrepreneurship is not provided. Third, the literature focuses on explaining how different types of institutions foster “high-growth” or “high-impact” entrepreneurship (Davidsson and Henrekson 2002; Henrekson 2005; Henrekson and Johansson 2009). While this leads to a focus on “technology-intensive” (OECD 1998), “R&D-intensive” (Schreyer 2000), or “knowledge-intensive” (Delmar et al. 2003) ventures, incrementally innovative ventures, their needs, and institutional drivers tend to be overlooked.

The VoC literature makes it possible to address these three problems. First, taking the perspective of historical institutionalism and in line with North (1990, p. 3), the VoC literature clearly defines institutions as “... formalized rules that may be enforced by calling upon a third party” (Streeck and Thelen 2005, p. 10). Institutions thus are the written or verbally agreed rules of the game which lead to a systematic behavior of actors—individuals and organizations, such as entrepreneurs and their ventures. Compared to rational-choice institutionalism, the VoC literature thus takes a broader perspective, including informal institutions that develop on the basis of less formal agreements than written rules (such as laws or contracts). At the same time, the VoC literature, in line with Ostrom (1990), focuses on those institutions that provide capacities for deliberation, the exchange of information, monitoring, and the enforcement of agreements (Hall and Soskice 2001a, pp. 9–12). In this regard, the VoC literature has a more focused understanding than sociological institutionalism: While shared understandings (such as norms, values, and culture) provide the basis for the development of (informal) institutions, the latter “... must be reaffirmed periodically by appropriate historical experience” (Hall and Soskice 2001a, p. 14), in order to remain viable as rules upon which third parties can be called.²

Second, the VoC literature offers a parsimonious theoretical framework to identify a core of institutions which influence any business activity (Hall and Soskice 2001b). To this end, the VoC literature draws on the insights of economic theory (Milgrom and Roberts 1992; Teece and Pisano 1998; Williamson 1985), as well as the resource-dependence view (Pfeffer and Salancik 1978), which illustrate that three types of resources are essential for any business to operate: labor, finance, and know-how. These resources are considered as most important because firms can only secure them after solving a collective action problem with external economic actors, namely their workforces, financiers, and R&D partners. Institutions channeling the resources between firms and their workforces, financiers, and R&D partners can therefore offer comparative advantages and are thus considered to be economically most influential. Accordingly, the VoC literature illustrates how education-related together with labor-market institutions, finance-related institutions, and institutions governing inter-organizational collaborations are shaped differently between countries, and it explains how these institutional constellations together lead to different,

²For a more in-depth understanding of how different schools of thought differ from each other in their understanding of institutions, see (Koelble 1995; Hall and Taylor 1996).

complementary institutional environments on the one hand and to different types of corporate behavior on the other.

Third, based on these theoretical considerations, the VoC literature convincingly argues that incrementally innovative firms are institutionally supported by a regulated environment. To illustrate this point, the VoC literature (Hall and Soskice 2001a) compares the regulated institutional environment of the Northern European countries, the so-called “Coordinated Market Economies” (CMEs), to the deregulated institutional environment of the Anglo-Saxon countries, or the “Liberal Market Economies” (LMEs). In doing so, the VoC scholars often illustrate their reasoning at the examples of Germany, which they consider the most typical CME, and the UK or USA, which are considered particularly typical LMEs. Later contributors to the VoC literature questioned the dichotomous distinction between CMEs and LMEs as they identified additional, particularly typical institutional constellations of country groups, most notably Mediterranean Market Economies (MMEs) and Eastern Market Economies (EMEs) (for example Amable 2003; Hancké et al. 2007; Schneider and Paunescu 2012).

Based on these distinctions, I here summarize our FIRES studies which illustrate that radically innovative entrepreneurship is facilitated by a deregulated institutional environment (that is typical for Anglo-Saxon economies), whereas regulated institutional constellations (typical of Northern European countries) facilitate incrementally innovative forms of entrepreneurship. The over-regulated or rapidly liberalized institutional environment of Southern and Eastern European economies, respectively, facilitate reproductive entrepreneurship based on the imitation of existing business ideas. Applying the VoC reasoning to new ventures explains why high-growth, radically innovative entrepreneurship develops particularly frequently in the deregulated institutional environments of LMEs, including the Anglo-Saxon economics such as the USA, UK, and Ireland.

Beginning with *labor*, the VoC literature highlights the free-riding problem related to the training of specifically skilled workforces (Dencker et al. 2009; Hall and Soskice 2001b). Given that the education and training system of LMEs tends not to be coordinated via a country-wide dialog between the social partners, sophisticated industry-wide job classifications that could serve as a basis for training workforces do not exist. Workforces therefore acquire a versatile skill set which they can use in different work environments. Upon completion of education trajectories, the flexible labor-market institutions of LMEs further strengthen the general skills of workforces. Short notice periods, dismissal without substantial reasons, and weak work councils imply that workforces are faced with hire-and-fire at short notice and change jobs frequently. Workers therefore acquire general skills that are useful for, and thus adequately rewarded by, all firms needing a certain business function. Importantly, such general skills imply that workers are particularly imaginative (thanks to the different work environments they have seen in different firms) and flexible as they are used to adapt to new corporate environments. Radically innovative firms, in turn, do not only require the capacity to imagine completely new business ideas but are also characterized by rapid changes. Flexible workforces with general skills are thus particularly well equipped to develop radical innovations. In sum, the flexible

education and labor-market institutions of LMEs thus facilitate the development of radically innovative ventures as they equip workforces with general skills (see also Herrmann and Peine 2011).

In addition to labor-market institutions, also those institutions governing the access to venture *finance* facilitate the development of radically innovative ventures in LMEs. The VoC literature shows that institutions differ in how they address the principal-agent problem related to the provision of shareholder capital (Hall and Soskice 2001b; Kenyon and Vitols 2004; Vitols 2001). To be willing to invest, shareholders need to be assured that their funds are used in the most efficient way by the firm's management. In LMEs, supervisory boards overlooking the activities and decisions of the management board of directors do not exist. While shareholders directly elect corporate managers, they have little or no systematic insight into, or control over, managerial investment decisions via a supervisory board. Consequently, managers have unilateral power to take major strategic and financial decisions, while shareholders can monitor the soundness of managerial decisions only through the development of equity prices at the stock market. This, in turn, drives managers to maximize returns on investment by engaging in high-risk, radical innovation projects. Radically innovative start-ups are therefore a particularly attractive investment option for venture capitalists. Venture capital investments into start-up firms are furthermore facilitated by the private pension systems of LMEs, which imply that comparatively high sums destined to build up future pensions are invested *inter alia* in venture capital firms. Accordingly, the pension and corporate governance systems of LMEs facilitate the development of radically innovative ventures.

The VoC literature furthermore highlights how solutions to hold-up problems, related to inter-organizational development of *know-how*, facilitates the emergence of radically innovative ventures (Hall and Soskice 2001b; Tate 2001; Teubner 2001). Start-up firms often engage in R&D collaborations with other organizations, such as research labs, universities, or suppliers, in order to jointly develop new products or services (Lundvall 1992; Tate 2001, pp. 444–446). But such joint developments also bear the risk of hold-up. The latter occurs whenever two or more actors try to appropriate the intellectual property (IP) developed by their cooperation partner(s) without having contributed proportionally to the knowledge development (see Klein 1996; Rogerson 1992, p. 777). Institutions governing inter-firm collaborations influence the ways in which companies can protect themselves against such IP drift or theft, depending on how institutions facilitate the enforcement of R&D contracts between collaboration partners (Tate 2001; Teubner 2001). In LMEs, the case-by-case decisions of lay juries or judges make the outcome of lawsuits unpredictable. Consequently, start-up firms often shy away from approaching courts to have the contractual obligations of their R&D collaboration partners enforced. This, in turn, does not only discourage firms to engage in large-scale R&D cooperation where the risk of hold-up is simply higher, but it also stimulates fierce competition between potential collaboration partners, which is at the basis of radical innovation.

While these VoC arguments explain why radically innovative ventures occur with particular frequency in the Anglo-Saxon LMEs (most notably in the USA and the UK), the VoC literature also explains why the regulated institutional environment

of the Northern European CMEs (in particular, that of Germany) facilitates the development of incrementally innovative ventures.

With regard to *labor skills*, the VoC literature highlights how workforces in CMEs tend to acquire company-specific rather than general skills (Hall and Soskice 2001b). The acquisition of company-specific skills is essentially induced by regulated labor-market institutions which prohibit the hiring-and-firing of employees at will. Unless they fall under exempt regulations, such as start-up companies of less than 10 employees, ventures can only dismiss employees for limited reasons, after respecting specific notice periods and involving the ventures' work councils. Often, temporary forms of employment can also be strongly protected with the intention to gear them toward permanent employment (Dencker et al. 2009). Given that these institutions tie employees to the same firm for a long time period, employees in CMEs tend to have in-depth firm-specific knowledge and long-standing relationships with their firms' suppliers. Such firm-specific skills enable workforces in CMEs to autonomously propose and develop improvements which translate into incremental innovations and high-quality products. At the same time, given their focus on just one (or a few) corporate environments, workforces with firm-specific skills lack the imaginative capacity and adaptiveness arising from frequent job changes. While workforces with firm-specific skills are thus less likely to come up with radically innovative ideas, they are particularly well equipped for developing incremental innovations (Herrmann and Peine 2011).

In addition, the pension and corporate governance systems of CMEs, institutionalizing the access of ventures to *finance*, tend to facilitate the development of incrementally innovative ventures (Hall and Soskice 2001b; Kenyon and Vitols 2004; Vitols 2001). Venture capital tends to be scarce in CMEs especially when the public pension system is a pay-as-you-go scheme. In these systems, such as in Germany, the pension provisions paid in by the current working population are directly redistributed by the state to the retirees and not invested into profit-yielding projects, let alone venture capital funds.

Once limited liability ventures reach a certain size, a supervisory board typically needs to be established including employees as well as shareholder representatives. Given that the supervisory board needs to agree to major strategic investment decisions of the board of directors, managers have no unilateral decision-making power. On the one hand, this makes it difficult to rapidly invest into, or divest from, new business units, which is often necessary for radical innovations. On the other hand, shareholders with insights into, and a say about, how their funds are to be used are typically less interested in maximizing returns on investment in the short run. This is particularly true whenever members of supervisory boards represent large corporate stakeholders, such as the firm's "house banks" or suppliers. In these cases, the board members are often reluctant to agree that "their" venture engages in high-risk projects (even if these promise high returns) because radically innovative businesses are also more likely to fail. Supervisory board members thus tend to have a preference for the firm to engage in incrementally innovative projects because the latter typically have more stable and predictable (albeit lower) returns in the long run.

Furthermore, the hold-up problem related to joint *know-how* development with R&D partners is overcome by the code-based legal system of CMEs in general and Germany in particular (Hall and Soskice 2001b; Tate 2001; Teubner 2001). Because of the clearly defined conditions for IP infringements, the outcome of lawsuits is better predictable. Contractual obligations of R&D collaborations can therefore be enforced in a straightforward manner, which limits the risks of uncompensated IP appropriation by a collaboration partner. Additionally, if supported by the fairly reliable and efficient legal system, start-up firms in CMEs have a higher propensity to engage in R&D collaborations on a large scale (Herrmann 2008, Chap. 4). This, in turn, facilitates incremental product improvements rather than radical innovations.

Given that they are either all deregulated (LMEs) or regulated (CMEs), the institutions governing labor, financial, and supplier–producer relations in LMEs and CMEs are complementary, which implies that “... the presence (or efficiency) of one [institution] increases the returns from (or efficiency) of the other” (Hall and Soskice 2001b, p. 17). For example, the complementary availability of generally skilled workforces and easily accessible venture capital makes it disproportionately easier for nascent ventures to be radically innovative than this would be the case if the skill sets of national workforces had been geared toward firm-specific skills—even if venture capital was available—and the other way around.

Importantly, the institutional environment in Mediterranean and Eastern European economies are often not complementary. Consequently, nascent ventures typically lack the types or combinations of labor skills and financial resources that facilitate radical or incremental innovation. This, in turn, can explain why a particularly high share of new ventures in these economies is focused on reproducing goods or services at lower costs rather than developing radical or incremental innovations.

Due to their recent histories of extensive state intervention, firms in Mediterranean Market Economies (MMEs) have built specific capabilities of non-market coordination in the sphere of corporate finance. Given that venture capital from national investors is hardly available and that external shareholders are not well protected, venture funding is often provided by family members, friends, and acquaintances of the entrepreneur (Herrmann 2008, Chap. 3). While new ventures thus have access to small funding amounts, they have difficulties in acquiring larger funds from institutional investors which, in turn, are needed for developing incrementally or radically innovative products.

While MMEs are characterized by moderate levels of social protection and high public expenditure for poverty alleviation and pensions, national expenditures for education are limited. Together with a fragmented social dialog and stifling labor-market regulation, which makes dismissals of employees close to impossible, new ventures are reluctant to hire employees (Hall and Soskice 2001b). The human resources of new ventures are thus often very limited which, in turn, makes any kind of innovation difficult and rather leads firms to focus on the reproduction of products and services, which does not require a broader skill basis.

Together with a fragmented and unreliable judicial system that makes recourse to legal action in case of IP conflicts difficult, this gives firms in MMEs a comparative advantage in low-cost reproduction—with the exception of some niche markets, such

as furniture or fashion, where, for example, Italian firms compete on incremental innovations and design (Molina and Rhodes 2007).

Contrary to CMEs, employers in Eastern Market Economies (EMEs) are not willing to bear the additional costs of on-the-job training for inexperienced young workers. This, in turn, leads to a shortage of specifically skilled labor in EME ventures. But given that labor markets were rapidly deregulated in EMEs (with the exception of Slovenia) after the fall of the wall, workforces are comparatively mobile which, like in the LMEs, facilitates the acquisition of general skills.

Regarding financial markets, foreign direct investment is among the most important sources of capital. Domestic bank lending, the second most important source of finance, is dominated by transnational companies (Hancké et al. 2007; Nölke and Vliegthart 2009).

Together with a less reliable judicial system, this gives EMEs a comparative institutional advantage in the assembly and production of relatively complex and durable consumer goods. These comparative advantages are based on national institutions which combine low labor costs and a skilled population with substantial knowledge of medium-level technologies and the availability of foreign direct investment.

To conclude, the institutional environment of LMEs can be expected to facilitate the development of radically innovative ventures, CME institutions lead entrepreneurs to rather set up incrementally innovative ventures, whereas the institutional framework of MMEs and EMEs facilitates, slightly different types of, reproductive entrepreneurship.

4.3 Empirical Evidence

To test the empirical applicability of these theoretical arguments, we proceeded in three steps. In the first step (Dilli et al. 2018, pp. 293–309), we assessed whether the entrepreneurship-related institutions of the EU member states indeed form distinct institutional families. To this end, we operationalized the environment of overall 21 Western economies with regard to those labor-, finance-, and R&D-related institutions that, according to the VoC literature, are most influential on entrepreneurial innovativeness (Dilli et al. 2018, pp. 301–304). For each country, we determined the availability of workforces with general entrepreneurial skills on the basis of overall six OECD and GEM indicators.³ We furthermore measured the availability of venture finance by institutional investors with the help of four Eurostat and World

³To measure the extent of highly and generally skilled workforces, these indicators report (for each country): (i) the share of population with tertiary education, (ii) the percentage of researchers, and (iii) the amount of R&D transfers to entrepreneurial ventures, as well as (iv) the stringency of regular employment protection legislation, (v) the stringency of temporary employment protection, and (vi) the social spending on start-up incentives.

Bank indicators.⁴ Finally, we identified the reliability of supplier–producer collaborations on the basis of five World Bank indicators.⁵ This data was available for 20 EU countries as well as the USA.⁶

Having operationalized the institutional environment of these 21 countries, we wondered whether countries cluster into distinct groups on the basis of these institutions. In other words, which countries resemble—and respectively differ from—each other with regard to their entrepreneurship-relevant institutions? To answer this question, we run cluster analyses on the basis of all 15 aforementioned institutional indicators, which were measured at the country level and, depending on data availability, as the average of the 2004–2014 time span.⁷ The results of these cluster analyses are depicted in Fig. 4.1.

We find that the clustering corresponds remarkably well to the institutional families identified in the VoC literature. Accordingly, we find that countries form distinct families with regard to their finance-, labor-, and R&D-related institutions governing entrepreneurship. Importantly, the institutions we studied go far beyond the classical VoC institutions, as they influence the ease or difficulty with which entrepreneurial ventures, rather than incumbent firms, can acquire different types of finance, labor, and know-how. This makes it surprising that the country groups we identify are basically identical to the ones discussed in the VoC literature.

In line with the VoC literature, we called the different varieties of entrepreneurial capitalism which we identified LMEs, CMEs, MMEs, and EMEs. LMEs include the Anglo-Saxon economies (Ireland, the UK, and the USA) with permissive financial-market institutions and deregulated labor markets comprising scientific education systems teaching workforces general skills, as well as reliable legal systems governing inter-firm collaborations. In contrast, CMEs (including Austria, Germany, the Netherlands, Switzerland, Belgium, Norway, Denmark, Sweden, and Finland) are characterized by less permissive financial-market institutions, well-regulated labor markets based on vocational education systems that teach specific skills to workforces, and reliable legal systems supporting inter-firm collaborations. MMEs

⁴These indicators capture the influence of institutional investors on nascent ventures by reporting the extent (i) of protection of minority interests, (ii) of minimum capital requirements, (iii) of venture capital investments, and (iv) of recovery rates in case of venture failure.

⁵These indicators measure the reliability of legal procedures in case of lawsuits related to supplier–producer collaborations by capturing the extent (i) of enforcing contracts, (ii) of judicial independence, (iii) of impartial courts, (iv) of the protection of property rights, and (v) of the integrity of the legal system.

⁶More precisely, the countries covered include Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, the Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Spain, Sweden, Switzerland, the UK, and the USA.

⁷In order to identify possible changes that may have taken place in the countries' institutional environments over time, we also split our data into two groups: the periods of 2004–2009 and of 2009–2014, respectively. Importantly, though our separate analyses for these two time periods revealed that no major institutional changes have taken place, the results are very similar between the two periods. We therefore used the average of the 2004–2014 time span in the analyses and results presented below.

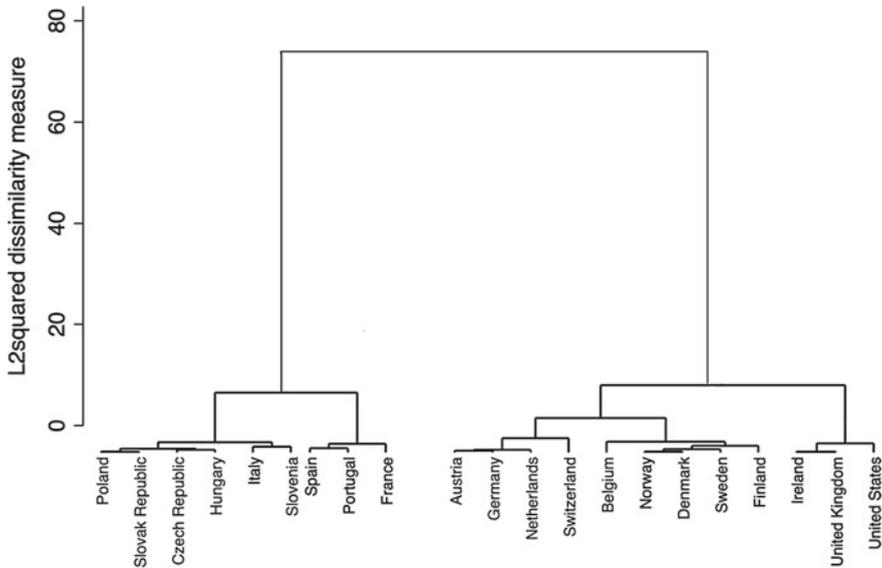


Fig. 4.1 Country families with similar entrepreneurship-relevant institutions. *Source* Dilli et al. (2018)

(including Italy, Spain, Portugal, and France), in turn, are characterized by constraining financial and labor-market institutions including education systems that mostly teach basic skills to workforces, and, with the exception of France, less reliable legal systems that make inter-firm collaborations difficult. Finally, EMES (including Poland, the Slovak Republic, the Czech Republic, Hungary, and Slovenia) are characterized by constraining financial-market institutions, well-regulated labor markets based on education systems that mostly teach basic skills, and unreliable legal systems that hamper inter-firm collaborations. In short, varieties-of-capitalism similar to the ones described in the VoC literature for established firms can be identified for nascent ventures with regard to those national institutions governing entrepreneurship.

We assessed the impact of these distinct varieties of entrepreneurship-related institutions on entrepreneurship in the second step (Dilli et al. 2018, pp. 309–320). Based on the VoC reasoning about the impact of institutions on entrepreneurial innovativeness, we would expect to find an above-average share of radically innovative ventures in LMEs, an elevated proportion of incrementally innovative ventures in CMEs, and a plurality of imitative ventures in MMEs and EMES. We assessed these hypotheses on the basis of several regression analyses. Taking the technology intensity of industries as indicator of entrepreneurial innovativeness, these analyses tested whether specific types of entrepreneurship (e.g., venture creation in technology-intense or, respectively, in less technology-intense industries) are particularly frequent in LMEs, CMEs, MMEs, and EMES, respectively.

Overall, our regression analyses lend support to the idea that the institutional constellations of LMEs, CMEs, MMEs, and EMEs support different types of entrepreneurship (Dilli et al. 2018, pp. 309–314). While these analyses can only establish correlations, not causalities, it is noteworthy that entrepreneurs in LMEs outperform their counterparts in other economies in the extent to which they found radically innovative, high-tech ventures which also grow fast. Entrepreneurs in CMEs often develop incrementally innovative ventures. That is, they create more high- and medium-tech ventures than entrepreneurs in EMEs and MMEs but also more low-tech ventures than their counterparts in LMEs, whereby these ventures are overall characterized by lower but sustainable growth. In contrast, entrepreneurs in EMEs specialize in less innovative product imitations. Accordingly, they are outperformed by entrepreneurs in both LMEs and CMEs in setting up high-tech ventures. However, EME entrepreneurs are decisively better in setting up medium- and low-tech ventures than their counterparts in CMEs and MMEs alike. Importantly, though, these ventures show little growth. Finally, innovative entrepreneurship is least developed in MMEs. Accordingly, MME entrepreneurs hardly set up any high-tech or medium-tech ventures compared to their counterparts in all other economies. At the same time, entrepreneurs in MMEs do outperform entrepreneurs in all other economies in the extent to which they set up low-tech ventures, whereby these ventures hardly show any growth.

Having established that distinct institutional constellations correlate with different types of entrepreneurship across Europe, we asked in a third step whether, and if so how, venture creation processes differ between countries. To this end, we collected a unique dataset of venture creation activities. More concretely, this dataset traces—on a monthly basis—the activities that nascent ventures undertake during their start-up period in order (1) to build up the necessary human resources, (2) to acquire funding, and (3) to develop product-related know-how. Based on optimal matching techniques, we analyzed—with a specific focus on country-specific differences—how ventures approach any of these three components of the start-up process. In short, our findings are presented below:

- (1) Beginning with human resources, two separate studies (Held 2019; Held et al. 2018) investigate how labor-market institutions influence the composition of start-up teams in nascent ventures. The influence of the institutional setting comes particularly to the fore in the first study, which analyzes the circumstances in which part-time entrepreneurs, who worked for the nascent venture less than 30 h per week, transition to full-time entrepreneurship (Held 2019). Interestingly, and in line with the expectations of the VoC literature, Held finds that part-time entrepreneurs in CMEs, such as Germany, are significantly less likely to transition to full-time entrepreneurship than those in LMEs, such as the UK and the USA, presumably because, in case of venture failure, it is particularly difficult in CMEs to regain a responsible position as a well-paid and well-insured employee. The study highlights that national labor-market institutions do not only elicit the emergence of a dominant type of entrepreneurship (Dilli et al. 2018) but also specific entry choices by the entrepreneur herself.

Having analyzed the entry processes of individual entrepreneurs, we investigate team formation processes at the venture level in an additional study (Held et al. 2018). To this end, we employ a definition of the venture team that goes beyond the founders involved in the creation of the venture and encompasses employees and external service providers. As a result of this broader conceptualization of team formation (in line with Cardon and Stevens 2004; Koch et al. 2013), our study discerns overall seven distinct approaches toward team formation. More concretely, the study does not only describe these seven-team formation processes with regard to the founder team but also uncovers the existence of distinct approaches to the hiring of employees and service providers. It furthermore shows that significant interaction takes place between the approaches to these three components of the venture team. While an additionality effect exists between founder team size and the hiring of employees, we observe substitution effects between the hiring of employees and service providers. Interestingly, the reliance on service providers is especially prevalent among nascent ventures in coordinated market economies. This finding is in line with the expectation of the VoC literature that entrepreneurs in CMEs are more reluctant to hire employees because dismissal at short notice is difficult which, in turn, elicits only low venture growth (Dilli et al. 2018). As such, our findings confirm that the VoC reasoning, originally developed in the context of established firms (Estevez-Abe et al. 2001; Hall and Soskice 2001b), also applies to nascent ventures—at least with regards to aspects of the team formation.

- (2) In another study (Held et al. 2018a), we find that nascent ventures follow one of seven distinct processes of funding acquisition. The majority of ventures follows one of the two processes that fit the expectations formulated in the financial bootstrapping literature: these nascent ventures rely almost exclusively on the funding of their founders (Winborg and Landström 2001), but a small yet significant number of ventures deviates from this process. These ventures acquire funding from other sources than their founders. The type of funding a venture acquires correlates with various venture characteristics such as the type of good that it develops, the product's novelty, venture size, industry, as well as its institutional context. With regard to the latter, we find that ventures in countries with a higher stock market capitalization, such as the UK and the USA, are less likely to seek debt finance. This, in turn, lends empirical support to the VoC idea that the availability of institutional (venture) capital influences the financial sources into which ventures tap to finance their endeavors.
- (3) Finally, we find in a third study that nascent ventures in LMEs are less likely to engage in R&D collaborations with external partners, such as universities and laboratories, than nascent ventures in CMEs (Held et al. 2018b). This, in turn, supports the VoC idea presented above that nascent ventures are more careful to engage in external R&D collaborations whenever the institutions governing inter-firm collaborations make the outcome of lawsuits in case of disagreement of the collaborating partners less predictable.

Taken together, these studies lend support to the theoretical arguments that a distinct set of national finance-, labor-, and R&D-related institutions correlates with the development of different types of entrepreneurial innovativeness across the European Union. While the deregulated institutional environment of Anglo-Saxon economies implies that an above-average share of radically innovative ventures is founded in LMEs, an elevated proportion of incrementally innovative ventures is set up in CMEs, while a plurality of imitative ventures is founded in MMEs and EMEs.

4.4 Implications for Entrepreneurship Research and Policymaking

In light of this empirical evidence supporting the VoC argument that distinct institutional constellations facilitate different types of entrepreneurship, which implications arise for entrepreneurship research and policymaking?

As we have argued elsewhere (Herrmann 2019; Dilli et al. 2018), entrepreneurship research would first of all benefit from assuming a more parsimonious approach toward investigating the link between institutions and entrepreneurship. The work of Dilli (forthcoming) offers a useful example in this regard. One of the major insights resulting from the VoC framework is that economic actors in different institutional environments need to behave differently in order to achieve the same outcome. And as a corollary, if economic actors across national institutions behave alike, this behavior tends to result in different outcomes. To give an example, ventures that go public in order to raise funds for increasing their R&D activities are likely to become radically innovative in the USA and incrementally innovative in Germany. Germany's corporate governance and education systems as well as the regulated labor market imply that the resources for radical innovations are less available and, hence, more expensive. This makes radically innovative entrepreneurship in Germany considerably more difficult while facilitating incrementally innovative entrepreneurship. Germany's entrepreneurs thus need to behave differently from their USA and UK counterparts if they want to achieve the same outcomes. Meanwhile, start-ups in the UK have difficulties recruiting and retaining specifically skilled workers to grow their businesses into export champions, as this arguably requires a disciplined and loyal workforce that is harder to attain in LMEs. If British and German founders behave alike, they will achieve different outcomes, while different behaviors are required to achieve the same outcome. Research into such questions of institutionally induced equifinality can offer a novel approach to investigating the link between institutions, entrepreneurial behavior, and outcomes.

The entrepreneurship literature can furthermore benefit from the finding that entrepreneurship types diffused in one institutional environment do not serve as a role model for entrepreneurship in other institutional environments. To put it bluntly, Silicon Valley cannot be a role model for the Continental European economies because of their institutional differences. But neither is Baden-Württemberg, known

for its incrementally innovative firms, a suitable role model for the Midlands. Such insights force the entrepreneurship literature to acknowledge that different institutional constellations allow for different types of entrepreneurship to flourish.

This also has important implications for policymaking. The VoC framework highlights that institutional constellations which are at the same time conducive to radically innovative, high-tech entrepreneurship and incrementally innovative, medium-tech entrepreneurship do not exist and may in fact be impossible to create. Policymakers are therefore faced with a trade-off and the question about which entrepreneurship type to facilitate. Of course, as laid out in the final chapters of this volume (Sanders et al. 2020a, b, c), policymakers can design individual policy measures to stimulate those types of entrepreneurship that are currently less supported by their national institutional environment. But historically grown institutional complementarities imply that one has to make a choice whether to support radical, incremental, or imitative innovation.

Policymakers should be aware of these trade-offs and carefully consider the interplay of institutions. While labor protection has a negative impact on the development of radically innovative, high-tech entrepreneurship, it stimulates the development of incrementally innovative, medium-tech entrepreneurship. Germany, for example, is characterized by a lively start-up scene in this area (see Dilli et al. 2018; Herrmann 2019; Pahnke and Welter 2019). Finally, one should keep in mind that the regulation or deregulation of labor and financial markets has broader societal implications that may be undesirable. To give just some examples: strong wage inequalities and increasing disparities between the rich and the poor, as well as systematic underinsurance against the risks of disability, old-age poverty, and illness that seem to come with LMEs' deregulated labor markets. Similarly, high capital market volatility and risky investments go hand in hand with deregulated financial markets. From the above research, one can conclude that a one-size-fits-all institutional constellation that stimulates radically and incrementally innovative and imitative entrepreneurship while facilitating social cohesion does not exist and cannot be created. There is no blueprint. The best policymakers can hope to do is experiment with small improvements, carefully assessing their policies' impacts as they go along.

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