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Institutional imprinting, entrepreneurial agency, and private firm innovation in transition economies

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ABSTRACT

We study private firm innovation at an advanced stage of institutional transition in Central and Eastern Europe and the Commonwealth of Independent States. We adopt an integrated view, where the institution-based view of strategy is complemented by institutional imprints and entrepreneurial agency to argue that innovation at that stage of transition depends on private firm founding conditions earlier during the transition and on recent strategic initiatives to exploit specific opportunities, improving the innovation capacity of firms. In a ten-country sample of 2322 private firms, we find that firms founded earlier and those of larger size at inception are better at innovation because of imprints favoring network-based approaches. Innovation is even greater when these firms' top manager has less industry experience, suggesting complementarity between network- and resource-based approaches. Additionally, firms that upgrade their management knowledge and improve their operational efficiency achieve higher innovation, and the effect of the former is augmented with a greater foreign market focus. Our findings also suggest that the role of entrepreneurial agency is stronger than that of institutional imprinting. These results have important implications for the institution-based view of strategy and private firm innovation in transition economies of CEE and CIS.

1. Introduction

Judging by the experience of transition economies in Central and Eastern Europe (CEE) and the Commonwealth of Independent States (CIS), the relationship between national institutional transitions from centrally-planned to market-based regimes and the achievement of firm innovation is complex (Meyer & Peng, 2005; Radosevic, 1999). On the one hand, a market-based system is expected to provide more adequate incentives for firms to allocate resources efficiently and generate innovations (Makhija & Stewart, 2002; Shinkle & Kriauciunas, 2012; Svejnar, 2002). On the other hand, the institutional transition requires a prolonged time lag, during which new, and radically different, formal institutions develop (Peng, 2003; Roth & Kostova, 2003). This period of institutional transformation poses substantial challenges for the organizational transformation of privatized enterprises (Uhlenbruck, Meyer, & Hitt, 2003) that could disrupt their innovative potential, even when they were successful at innovation under the old regime (Kogut & Zander, 2000). It also poses challenges for newly established private firms, which are disproportionately affected by underdeveloped formal market institutions because of their traditional resource and legitimacy liabilities combined with the hazards of unfavorable government treatment (Meyer & Peng, 2005).

The expectation is that at an advanced stage of transition, the market system functions sufficiently well to stimulate innovative action like that in advanced market economies. An advanced stage of transition refers to a period when transition economies have made substantial strides to achieving a functioning market system, macroeconomic stability, and sustainable economic growth, but are still in the process of convergence with advanced economies in terms of per capita income and standard of living. Generally, under a well-functioning market system innovative action is directed toward the exploitation of resource-based innovation capacities, such as specialized expertise and management systems (Cohen & Levinthal, 1990; Henderson, 1994), and network-based innovation capacities, such as relationships with other businesses that allow greater access and exchange of information and knowledge (Adler & Kwon, 2002; Jones & Macpherson, 2006).

However, it is unclear by what organizational mechanisms private firms arrive at this type and level of innovative activity at an advanced

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stage of institutional transition. We examine the role of two factors − institutional imprinting and entrepreneurial agency, to improve our understanding of the challenges and opportunities to achieving greater innovation in this context. First, surviving private businesses were founded at an earlier stage of transition (either through privatization or as new ventures) and the way they coped with the institutional environment at that stage could have left imprints (Marquis & Tilcsik, 2013; Stinchcombe, 1965) influencing their innovative behavior at a later stage. The nature and degree of imprinting are not equal and may vary across private firms as they are founded at different points in time during the transition or of different sizes. Moreover, because imprinting may take place at the organizational or individual level (Marquis & Tilcsik, 2013), there can be an interaction between the firm's founding characteristics and the industry-specific experience of its top manager.

Second, while at an advanced stage of transition formal market institutions generally stimulate market-based strategic choices (Peng, Wang, & Jiang, 2008), not all firms are equally adjusted to the incentive structures and mechanisms of the new institutional regime (Banalieva, 2014). We argue that the connection between prevailing market institutions and the ability of firms to adopt market-based innovation strategies is not automatic, but rather depends on their entrepreneurial agency to take advantage of opportunities afforded by the new institutional framework. In this context, entrepreneurial agency can take the form of specific strategic initiatives to develop resource-based innovation advantages. Because private firms in transition economies are generally disadvantaged in their innovation resources early during a transition (Makhija & Stewart, 2002; Radosevic, 1999; Svejnar, 2002), strategic initiatives to strengthen such resources later would be beneficial to firm innovation. Additionally, initiatives with a foreign market focus may further intensify innovation because of greater opportunities (Coviello & Cox, 2006; Harris & Wheeler, 2005).

This study contributes to the institution-based view of strategy, which was developed largely in response to research on transition economies (Meyer & Peng, 2005; Peng, 2003; Peng et al., 2008; Peng, Sun, Pinkham, & Chen, 2009). According to this perspective, firms rely on informal institutions, particularly those associated with relationship-based exchange, when formal market-supporting institutions are underdeveloped, and as the latter become more established, firms rely increasingly more on their resource base to formulate market strategies. The model developed here provides a richer understanding of firm innovation at an advanced stage of institutional transition by advancing an integrated view, where the institution-based view of strategy is expanded to incorporate institutional imprints and entrepreneurial agency. Additionally, the model allows us to compare the deterministic effects of institutions (through imprinting) and the role of agency (through strategic initiatives) in the context of private firm innovation in transition economies.

2. Theory and hypotheses

2.1. Organizational innovation

Organizational innovation refers to a process of creating and implementing new ideas in the organization (Daft, 1978; Damanpour, 1996). Some outcomes of innovation are new product introductions and new technological inventions (Kanter, 1983; Zahra, 1996). To innovate, firms need to find solutions to different problems by recombining knowledge, which can be already existing or new to the organization (Amabile, 1988; Henderson & Clark, 1990). Successful innovation requires strong innovation capacities in the form of knowledge depth in specific areas and knowledge scope across different areas (Henderson & Clark, 1990), as well as organizational capabilities to innovate, which develop over time through a complex evolutionary process (Cohen & Levinthal, 1990; Henderson, 1994). Additionally, firms can facilitate their innovation process through networks, which help them access complementary resources and information (Adler & Kwon, 2002; Jones & Macpherson, 2006). Through a greater number and quality of relationships, firms have more opportunities to learn and combine knowledge to produce innovations (Tsai, 2001; Yli-Renko, Autio, & Sapienza, 2001).

2.2. Innovation in transition economies of CEE and CIS

The start of the institutional transition marked the beginning of a new era for the innovative activity in the region. During the centrally-planned regime, a substantial portion of the innovative process was outside the control of enterprises and conducted across different institutions such as Academies of Sciences, ministries, and branch institutes (Radosevic, 1999). The general belief is that this organization of innovative activities was rigid in stimulating innovation in comparison to the organization of innovation in market economies, explaining to a large degree the economic slowdown in the region since 1960, as well as the increasing gap with the technological frontier in market economies (Svejnar, 2002). By initiating an institutional transition toward a market-based regime in the late 1980s, transition governments aimed to stimulate economic growth and development (Peng & Heath, 1996), in which a market-based organization of innovation played an important role.

With the start of the institutional transition, innovative activity was reorganized by dissolving the former science and technology system and obligating enterprises to undertake the majority of the innovation process, as well as by allowing private ownership (former state-owned enterprises were gradually privatized and many new private firms were established) and liberalizing markets, which improved incentives for innovation (Radosevic, 1999). This process proved challenging because the new private firms began their innovative activities anew at inception and the privatized firms had to adapt to a completely different system. Indeed, even enterprises that conducted innovation successfully under the old regime were struggling with the challenge of continuing these activities in an external environment that disrupted the organizational routines underpinning such innovation (Kogut & Zander, 2000). The expectation was that with improvements in formal market institutions, innovative activity would increase. Indeed, such a positive correlation between formal institutional development and innovation activities was corroborated in comparisons of innovation data from CEE and the European Union in the mid-1990s (Radosevic, 1999).

2.3. Institution-based view and institutional transitions

The institution-based view of strategy helps understand the prevailing types of strategic choices firms make at different points during an institutional transition. This institutional perspective focuses on the interaction between institutions and organizations, and suggests that strategic choices are direct outcomes of such interaction (Peng et al., 2008; Peng et al., 2009; Peng, 2002). It builds on the key idea that institutions create pressures for compliance to formal (laws and regulations) and informal (cultures, norms, and customs) constraints (North, 1990) through expedience, social obligation, or taken-for-granted mechanisms among all social actors (DiMaggio & Powell, 1983). According to the two main propositions of the institution-based view, strategic choices take place within formal and informal constraints in a given institutional framework and when "formal constraints are unclear or fail, informal constraints play a larger role" (Peng et al., 2009: p. 68).

Institutional transitions stimulate a specific interplay between formal and informal institutions. First, establishing a market-based institutional system requires a long period of incremental evolution due to the gradual introduction of new rules to govern market-based transactions and increaded strengthening of mechanisms to enforce existing rules, as well as the substantial resistance by some incumbent organizations to change (Hoskisson, Eden, Lau, & Wright, 2000;