

How Does Institutional Context Influence Entrepreneurial Processes of Sri Lankan Small Businesses?

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Abstract

Contribution of entrepreneurship for economic growth and social development is univocal among entrepreneurship researchers. However, economic growth statistics show that entrepreneurship has not been worked as a development strategy for many developing countries including Sri Lanka. Thus, this study aimed to examine the influence of institutional context on small businesses in selected contexts in the North Western province following an inductive approach using the case study method. To understand the variation of influence of institutional context, two contrasting contexts were selected from the North-Western province: *Kurunegala Township* and *Degoda-Thurawa*. *Kurunegala Township* was selected to represent formal institutional context and *Degoda-Thurawa*, which is one of the poorest villages in *Kurunegala District* was selected to represent self-evolved traditional village where informal institutions are strong. After screening over 100 cases in each context, eight cases were selected in two stages to explore the entrepreneurial processes of small businesses. Using pattern matching techniques, this study found that macroeconomic policies work better in urban context where the number of innovative opportunities identified and exploited is comparatively higher than those of in the rural context. This study concludes that entrepreneurship may not influence on economic growth or social development, by merely changing fiscal and macroeconomic policies without addressing the problem of inertia emanated from informal institutions in the rural sector.

Keywords: *context, entrepreneurial process, entrepreneurship, small business*

1. Introduction

Entrepreneurship researchers are showing interest to understand ‘why’ and ‘how’ only some individuals exploit opportunities with superior benefits and grow their small businesses successfully but not others (Shane, 2003). Behaviour of entrepreneurs may explain how different individuals perceive opportunities and carry out activities accordingly. However, Zahra and Dess (2001) contend that the interaction between context and individual opportunity nexus is rare in entrepreneurship literature. They further argue that the validity of entrepreneurship

research is questionable because the contexts that have been taken into account were not clearly explained by the researchers.

Hence, this paper explores the influence of context on entrepreneurial process by examining behaviour of entrepreneurs in different contexts by raising the research question of 'how does the institutional context influence on the entrepreneurial process of small businesses?'. This study attempts to reveal the important relationships between the entrepreneurial process and context by examining the entrepreneurial process of small businesses in two contrasting contexts in the intermediate zone (climatically) in Sri Lanka over nine months in 2010.

Research Problem

Generally, population density of the businesses in the urban is higher than rural locations (Lucas, 1978; Acs, 2006). Majority of these businesses are small businesses. Most of these businesses are ordinary retail businesses which are termed as 'economic core' (Thurik & Wenekers, 2001). According to economic literature pertinent to entrepreneurship, individuals who are talented, choose self-employment while less talented seek wage employment (Lucas, 1978). Lucas theory postulates that expected returns are the key to choose self-employment. These expected returns may mostly depend upon economic environment of which monetary and fiscal policies are constituents (formal institutions). Generally, these formal institutions are not equally effective in all the settings which are dichotomized as rural and urban. As a result, majority of entrepreneurs are subjected not only to those variations of macro-environment but also the evolving institutional contexts in respective settings. Environment in this paper refers to macroeconomic environment and the context refers to the immediate environment and the task environment where those small businesses are embedded.

Majority of entrepreneurship researchers attempted to explain the variation in distribution of small businesses either from the opportunity point of view or individual point of view (Gartner, 1988). Opportunities were dichotomized as innovative (Schumpeter, 1934) and less innovative (Kirzner, 1979). Individuals were assessed according to their behaviour in opportunity discovery and exploitation as these behaviours are regarded as the heart of entrepreneurial process (Gartner, 1988). Entrepreneurial process takes place not in a vacuum but in a context which also been subjected to the macroeconomic variables introduce from time to time. It is reasonable to argue that there could be a variation of small businesses even if they are based upon similar opportunities exploited by similar individual entrepreneur but embedded in different contexts. Then the research question addressed in this study is, how the institutional context influences on the entrepreneurial processes of small businesses. Only few studies in entrepreneurship literature provide evidence for using contexts as independent variable. Miller and Shamsie (1996) used two environments to test the growth of firms in film industry. Dreyer and Gronhaug (2004) used turbulent institutional environment and uncertain competitive environment to examine the flexibility of small firms to attain growth. However, both studies used macroeconomic variables and statistical sampling for their studies.

2. Literature Review

Distinguishing entrepreneurs from non-entrepreneurs has not yet been resolved. Kilby (1971) stated that it doesn't know who an entrepreneur is, how can possibly sample them and investigate what they are look like. Therefore, entrepreneur should understand what they do (activities and processes) and not who they look like (Gartner, 1988). Shane and Venkataraman (2000) define entrepreneurship as an activity that involves the discovery, evaluation and exploitation to introduce new goods and services, ways of organizing, markets, processes, and raw materials through organizing effort that previously had not existed (cited by Shane, 2003). However

they posit that this definition cannot be operationalized and put forward two operational definitions of entrepreneurship for empirical research: (1) self-employment which performs for personal profit rather than wages, (2) founding of new business (Shane, 2003). This implies that entrepreneurship has to be empirically investigated through self-employment or business entities. In consistent with these definitions, this study operationalizes entrepreneurship as small business operators engage in business activities (not necessarily entrepreneurial) and examining their opportunity identification and exploitation behaviour (activities/processes).

As mentioned in the preceding section, talented individuals seek self-employment in order to gain higher returns than the wage employment (Lucas, 1978). Whenever size distribution of small business is concerned, most often majority of businesses are located in the urban sector. Among the possible explanations for uneven distribution of small businesses between urban and rural include the availability of opportunities which yield superior benefits (Storey, 1982; Baumol, 1990) and the talented individuals (Lucas, 1978).

Shane (2000) defined entrepreneur as an individual who has identified and exploited at least one opportunity. According to Shane (2003), entrepreneurship is the interaction between individual and opportunity which also may determine the type of entrepreneur. Similarly, Ucbasaran (2004) contended that number of opportunities identified and exploited by an entrepreneur would determine the type of entrepreneurs. Moreover, entrepreneurs are defined under three well-established criteria including business ownership, decision making role, and ability to identify and exploit opportunities. Ucbasaran, Westhead and Wright (2006) and Ucbasaran (2004) categorized entrepreneurs as: novice, habitual, serial and portfolio and termed novices are the ones who have exploited one opportunity. Habitual entrepreneurs exploited more than one opportunity sequentially or concurrently. The former is termed as serial entrepreneurs and latter it is termed as portfolio entrepreneurs. This categorization may help to identify successful small businesses according to the number of opportunities identified and exploited. Also it could help to rank small businesses in each context. Opportunities are further categorized according to the innovativeness (Shane, 2003): less-innovative opportunities (Kirzner, 1979) and innovative opportunities (Schumpeter, 1934). This study assumes that the number of opportunities identified and exploited would determine the conduciveness of context, in terms of institutions, for business entry and business growth.

Even though opportunities are available; there must be an agent to exploit opportunities (Shane, 2003; Wiklund & Shepherd, 2003; Storey, 1982). When the capable individuals are lacking, number of opportunities exploited may be limited because fewer individuals are there to exploit opportunities. Socio-economic data (Central Bank of Sri Lanka, 2005) reveals that higher the level of education, lower their tendency to remain in the rural areas and hence there is a migrating tendency of most of the educated individuals even the entrepreneurs, to urban. This may consistent with Lucas theory on distribution of individuals across rural and urban settings.

Moreover, some scholars argued that education is associated with enterprising individuals (i.e., Shane, 2003; Eckhardt & Shane, 2003). However, majority of researchers have used formal education as human capital which influence entrepreneurship. However, Ucbasaran et al., (2006) stated that education should be considered in broader sense including, ownership experience, number of opportunities exploited, and experiential learning. This study adopts education in broader sense and termed as human capital. Further it assumes that availability of capable individuals (enterprising individuals) is higher in the urban context than rural context. Having discussed the concentration of educated individuals in urban setting resulting in reducing human capital in the rural setting for opportunity identification and exploitation, the attention next focused on institutional context and explored possible influence for entrepreneurship.

Many conceptualizations of the environment are largely consistent with Aldrich and

Mindlin (1978) who describe environment as source of information, and stock of resources. This study assumes Aldrich and Mindlins’ (1978) explanation which also consistent with Burt (1992) and Granovetter (1985) theories of social capital and networks. Social capital has defined as “the sum of the resources, actual or virtual, that accrue to the firm by virtue of processing a durable network of more or less institutionalized relationship of mutual acquaintance and recognition”, (Bourdieu, 1986, as cited in Hoang, & Antoncic, 2003). Burt (1992) and Coleman (1988) define social capital as networks of relationships and assets. According to literature, urban entrepreneurs get most of the resources from business networks (Wiklund, 1999; Granovetter, 1985).

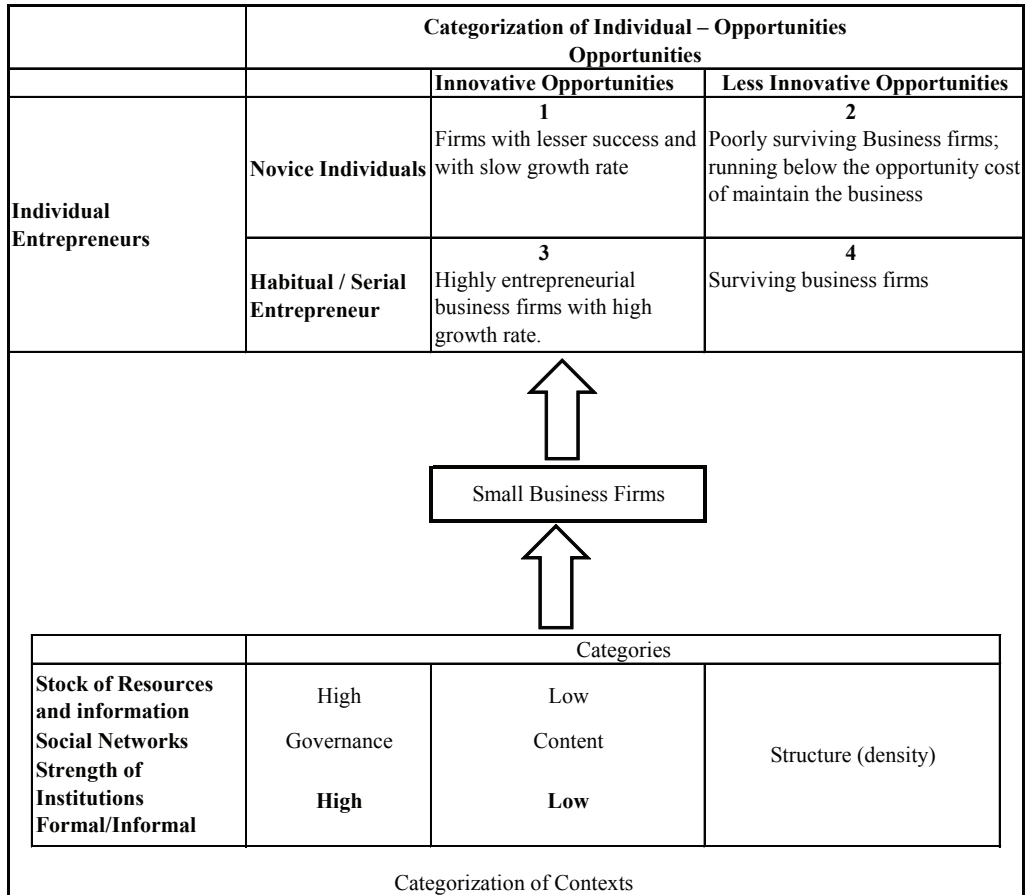


Figure 1: Conceptual Framework

Next important factor is to understand ‘what makes the context’. It is obvious that dwellers in the context and the governing mechanism of behaviour relevant to entrepreneurship (rules, regulation, norms, and traditions) are termed as institutional contexts. These institutional contexts either facilitate or constrain entrepreneurship (Welter, 2010; North, 1990, 1991). Norms, traditions, social networks fall into informal institutions while rules, regulations, fiscal and monetary policies fall into formal institutions framed mostly by the government of a country. Moreover, traditional rural societies in Sri Lanka use small businesses as a supplement to their main livelihood (agriculture). However, exploiting more opportunities may be a risk

for their farming activities. Their main strategy for avoiding uncertainty is distribution of risk among crops they cultivate (Kodituwakku, 1997). Thus, this study explores that the theory is deficient in explaining entrepreneurial behaviour on opportunity identification under risk and uncertainty. Also it is deficient in explaining influence of context on entrepreneurial process since influence of context on entrepreneurship is an emerging phenomenon. Therefore, it is logical to adopt theory building approach rather than theory testing one. The conceptual framework developed for this study is shown in figure 1.

3. Methods

This section deals with selecting a method for theory building research design and sampling. Sampling is a major threat faced by researchers since it is difficult to find a homogenous population to get a representative sample. Davidson (2005) concentrated the importance of conducting qualitative research design for entrepreneurship research due to following reasons:

- i. Entrepreneurship is a process, hence it cannot be captured by survey research methods
- ii. Individuals are heterogeneous and selecting a representative sample from a homogeneous population is difficult or impossible
- iii. Entrepreneurial behaviour is not continuous. Hence it is difficult to assume that they were engaged in entrepreneurial activities throughout the whole business life.

Then qualitative approach which applies case study analysis method is useful to eliminate above issues embedded in quantitative methods (Yin, 2003). Hence, this study uses case study research method to compare and contrast institutional variables in rural setting and urban setting through pattern matching techniques. As advocated by Eisenhardt (1989), maximum variation strategy is used to select contexts and the small businesses embedded therein. Accordingly, this study selected two extreme contexts in *Kurunegala* District and small businesses embedded in respective contexts. The research design of this study has two units of analysis: context and the small firms embedded in the context. According to Yin (2003), this design is termed multiple-embedded case design. As elaborated in table 1, the unit of analysis in this design are in two hierarchical levels: context is at higher level (urban or rural) and the firms embedded in the context are micro-level.

Table 1: Research Design of the Study: Multiple-embedded case design

Research question	Case study research design	Status of unit of analysis
Does the context, where small business owners/entrepreneurs embedded, influence the entrepreneurial process of small business firms?	Unit of Analysis at Miso level (context) Context : Rural/urban	Multiple embedded units of analysis

Source : Yin (2003, p:40)

4. Overview of Case Studies and Contexts

This research selected a township located in the climatically intermediate zone to minimize natural variables. *Kurunegala* District is one of the districts which meet the above requirement of minimizing variation of climate. The geographical location is ideal to maximize variations between contexts. *Kurunegala* Township is accessible from major cities such as *Kandy*, *Colombo*, *Negambo* and *Anuradhapura* while *Degoda-thurawa* has no easy access except by walking. Racial harmony exists in the township where all three religious groups are running their businesses in the town. All three major plantation crops, coconut, rubber, and tea are grown in the district but coconut is the main livelihood of people. As coconut is the least

labour intensive plantation crop, individuals have greater time for other activities than other two plantation crops, tea and rubber. The selected location for rural context is situated 60 kilometres away from Mahawa along the Kurunegala- Polpithigama road. Degoda-thurawa is constituted only with Sinhala Buddhists and the present generations are evolved from single origin about a century ago (evidence from villagers and Grama Niladhari). This village is self-evolved to sustain their livelihood over centuries. It is important to understand the self-evolved village from a village setup under the intervention of government.

Cases in Urban context

Case 1: This is about a youth who wanted to do business of his own but exactly does not know what business he wanted to begin with. His father was a teacher who taught engineering in a leading college in the town. His mother is a house wife and had a brother. From the childhood he used to repair his father's motor cycle and became familiar with motor cycle repairing. He was not successful in school education and decided to leave the school to start a business of his own. During that time, Kurunegala was famous for importing reconditioned motor cycles. He started his business in motorcycle repairing in 1986. However, the business was not successful and decided to get contracts in Mahaweli area on the information provided by a friend who was a mechanical engineer by profession. He did contract, mainly earth work, in Bakamuna in Mahaweli Development Area from 1986 to 1989. After the end of contracts he returned to his former workshop and started making florescent tubes with his brother (case 2). During that period televisions (TV) were introduced and people were interested in watching TV and lighting their houses. During that time National Engineering Research Development Institute (NERD) was introducing Direct Current (DC) florescent tubes for lighting houses. With the advice obtained from the NERD they started making florescent tubes for three years. They purchased raw material from Colombo dealers which hadn't prior contacts. Over the years they built relationship with several wholesale dealers in Colombo. When the local demand for tube is met they wanted to expand their sales to outside the township. Since they hadn't prior sales experience, they hired a sales representative who resigned from a similar position. Sales have grown in that period and however, they didn't receive enough cash compared to the units they sold. In the meantime, more producers entered into the market by imitating and with low-cost products. As a result they decided to stop the business activities after three years. In 1991, he received information from a neighbour about free training of rice-planters given by the Mahaiilluppalama Farm Machinery Centre (FMRC). After undergoing training at FMRC, they started to manufacturing rice – planters. During this period, they were selected to travel in several countries on a partial subsidy provided by the FMRC. In Australia he found pre-fabricated iron frame manufacturing industry and decided to start this business in Sri Lanka. During this transition period, he continued to make iron-gates, grills and other small-scale iron works to keep the business as growing one. During this time, his brother separated from this business with the purpose of starting his own business. While operating in the pre-fabricated iron frames production, in 1994, he started to manufacture water bousers to meet the demand for water in war-affected areas in the North and East. In 1997, he started to supply water to local areas using unsold water-bousers. Currently, he is manufacturing pre-fabricated frames, water bousers, and supplying water for rural areas. The theme emerging from the above case is relationship between opportunity seeking behaviour and the institutional context. Since 1978, liberalized economic policies were implemented and various development projects were launched (e.g. Mahaweli). Under this liberalized policies, people were in pursuit of satisfying needs which were not available in previous regime (e.g. TV, house-lighting). It also demonstrates the resources flow from the network (family, friends, and business networks).

Case 2: This is a case about a youth (the brother that has mentioned in the case 1) who had a wish to start a business after schooling. He was unable to complete his General Certificate of Education, Ordinary Level (GCE (O/L)) examination. After schooling, he joined with his brother for the business described in the case 1 until 1994. When he got married, the wife's relatives opted to help him. In 1994, he started making nuts and bolts for Ceylon Electricity Board (CEB) and got contracts through public paper advertisements. To make some specific items, he developed some machinery specifically for those items. The contracts with CEB were terminated in 1999 and he started making desks and chairs for Department of Education since 1999. These opportunities were created through a special education project launched by the government in 2000. He continued to do this business until 2001. At the end of the project, he decided to start a vehicle service station closer to the town. Since the chemical cost was high, he developed chemicals by himself after studying the composition of some major ingredients (e.g. car washing ingredients). Currently he is continuing this business. The themes emerging from the case are that innovative opportunity seeking behaviour of individuals could be changed by the formal institutional context. When opportunities created by the government are drying up, individual may seek risk free opportunity to continue the career as an entrepreneur.

Case 3: This entrepreneur has attempted to find opportunities with the changing macro-economic environment. He had attended to school up to grade 8. However, while schooling, he was working at his fathers' business of charcoal collecting and selling. When he was 20 years old, he had thought of doing his own business and search opportunities, particularly quotations for supplying old tires. He started his business by winning a quotation for supplying old tires for the Paper Corporation at *Valchchenei* in 1970s. While he was supplying old tires collected from locals, he was able to well known about the Northern Province. He understood the resources and opportunities available in the Northern Province and North-Western province. When he returned from *Valachchenei* after unloading old tires and charcoal, he started to bring salt from *Elephant-pass sultan*. Even after the contract of supplying old tires was over, he continued to supply charcoal to the North and salt to *Kurunegala*. Then he dreamed to import motorcycles and diversify his business further because *Kurunegala* town is very famous for selling of imported motorcycles. Unfortunately, in 1980s, the ethnic war was started and it has affected his new business idea of importing motor cycles and distributing further. However, he didn't give up his dream. He joined with his friend and started importing of motorcycles from Japan. When the availability of reconditioned motorcycles was increasing, margins have decreased with new entrants. Then he started to import bikes from Singapore even though the market had not been fully explored. However, when Singapore bikes are not good as Japan, he had spent considerable amount of money on repairs. In the meantime, he noticed the most vulnerable components in Japanese bikes. Silencers were one of them and started making silencers. He noted that the bend in silencer is difficult to manufacture with local technology and started storing bends of silencers to make completed silencers for popular models. Since the silencer production was lucrative, he recruited mechanics from South India. In the meantime he noticed an internet advertisement for old Bedford engine parts in Canada in 1999. He collected some Bedford parts and sent one consignment to Canada. In 2004 he was paralyzed but continued to work in the silencer production. The theme emerging from this case is the influence of institutional contexts on entrepreneurship. Under closed-market economic policies, the entrepreneur attempted to exploit non-innovative opportunities created by the government in 1970s. Under liberalized economic policies (after 1978), first started importing motorcycles from Japan and then from Singapore. When the profit margins were decreasing in importing bikes, business was switched into a comparatively low innovative business to maintain his business.

Case 4: This case is on a businessman who started the business with the liberalized

economic policies in 1989. First he worked as a manager of a timber depot in 1980 and came to *Kurunegala* in 1984 to start re-conditioned motorcycle selling business. At the beginning, he hasn't any knowledge about motor cycles and joined with a friend who had experience in motor cycle business. In 1988, they sold motor cycles by taking them to *Colombo*. He married to a woman of a wealthy family and with their support started importing re-conditioned motorcycles from Japan. In 1999, the stocks of reconditioned vehicles in Japan was declining and thus, started to import motor cycles from India and became a franchisee for popular brand for North-Western province in 2004. In 2006 he purchased a land close to town and started after sale service centre coupled with sales centre for reconditioned vehicles. Gradually that sale centre at *Kurunegala* started to decline due to new competition hence expanded business to *Kuliyapitiya*. Now he is a leading motor cycle trader in the town and elected to the presidency of the *Sinhala Traders Association* in 2008. The theme emerging from the case is the influence of liberalized economy in creating opportunities for business oriented people even without prior business experiences. If he hadn't married to a wealthy family, he may not be able to start the importing motor bike business. It also demonstrates the nature of serial entrepreneur who pursue opportunities sequentially.

Cases in rural context

Case 5: This is about a farmer who became as an entrepreneur over time. He had no any experience in formal schooling and since the early childhood he started farming. He started his career as a businessman in 1960s by collecting coconuts from village homesteads. First he sold fresh nuts when the price was good and decided to make copra from the remaining small coconuts. From the copra business, he fetched a good price and later on he found that his wife is idling. To make use of her time, converted part of his house to a boutique in 1978 and started a retail business. Concurrently, he started to exchange essential goods, first with coconut and next paddy, the main crop in the village. Since he became comparatively wealthy person in the village, he was elected as the president of the '*Awamangaladara Society* (a society which undertakes responsibility of funerals)' in which he had to safeguard the money of the society. During the period of insurrection in 1989, his money (Rs. 12,000.00) was looted and went bankrupt. Then he closed his boutique and started farming again in 1990. In the meantime, the village (*Degoda-thurawa*) was selected for external funding to provide pipe-borne water and he started working on it for wages in 1997. In the meantime a youth who engaged in these activities was married his daughter. Since his family responsibility was over, he handed over all activities to his son-in-law and stopped business activities. Currently he is continuing collecting of paddy with the assistance of his daughter and wife. They bought a two wheel tractor to plough the land and to transport the products. This case illustrate that either closed market or open market policies had no impact on entrepreneurial behaviour of rural people. Opportunities identified by rural entrepreneurs were non-innovative and linked only to the main livelihood of the village.

Case 6: This is about a person who embarks into business to exploit an opportunity with the development of infrastructure. He was working as a clerk for 15 years and started a paddy mill in 2005, when he was 51 years of old. When he worked as a clerk, he used his extra time for farming vegetables and sold the crops at *Dhambulla* which is about 25 km away from the hometown. The thought of starting electricity driven paddy mill with rubber rollers was generated due to his wife was idling. The paddy mills in the village have used diesel with iron rollers which tend to have waste the rice during the milling process. Grinding chillies and other essentials in traditional mills were not in good quality and took greater time for milling. He borrowed money from three friends to purchase equipment and huller was bought on loan basis from a merchant in the *Galtan-Wewa* junction. His mill was multipurpose and

could grind chillies and floor, husk paddy and extract coconut oil. When the villagers found his mill is more efficient in milling quality paddy he had a good business and used family labour productively. Currently he is running his mill successfully. Theme emerging from the case is exploiting opportunities under uncertainty. He has hypothesized the outcome of opportunities exploited many times and decided to go for informal borrowing although formal banks are in the closest town. He expanded the business internally (adding grinding chillies) by using family labour. Even though macro-economic policies hadn't an impact on his behaviour, infrastructure development (electricity) had given an opportunity to start a relatively innovative opportunity but depends on the raw materials (paddy) produce in the village to avoid uncertainty.

Case 7: This is about four brothers who moved from urban to rural to re-establish the unsuccessful business. The business was making coir for brushes, mattresses, and yarns. This business started in 1984 by his father in suburban area in *Gampaha* District. He employed around 35-40 individuals to make bristle fibre in the *Minuwangoda* in *Gampaha* District. With the fall of prices and lack of labour to employ in coir fibre industry coupled with increase prices of coconut husks, the industry was declining. As a result, they moved to *Hath-Pokuna* to relocate their business. At the young age, they had to take care of the business since father retired from business due to frustration. There were four brothers in the family and decided to uplift the business. The strategy to resolve the labour problem and high cost of production was to relocate business in *Hath Pokuna* to *Degoda-thurawa*. In 1986, *Hath Pokuna* was an isolated rural area without good infrastructure. However, plenty of idling labour and expansions of lands were available for cheaper prices. They collectively shared responsibilities. Elder brothers worked as a labourer to reduce the cost of production and gave the financial management support to youngest brother. The problems they faced include transporting products to *Colombo* and pricing finished products. To overcome the problem of lower prices and difficulties in transport, they decided to maintain quality of products and established reputation in the coir industry. They believed lower quality product is a waste for buyers and cannot be used for any industry as a raw material. By 1990, they were able to re-establish the industry. The number of products could be made out of husks were increased. The pith of coir could retain moisture for long-time and could be exported (before this demand for pith, removing heaps of pith was the biggest problem in the industry) as a growing-media. The major drawback of the coir industry is monopoly of fewer companies and the number of major companies dealt with coir is limited to 19. There was no market research for finding new market for coir or its by-products. Moreover, innovations were dependent only on the foreign demand. In 1992, they started making coir pith as a growing media since these new products were getting good prices. As result, prices for husks were increasing. At the beginning, husks were regarded as a waste and price for husks were negligible compared to the cost of transport. Again with the increased volume of growing media, prices were going down in early 2000. During the last four years (2005-2009) the industry started to decline due to lack of employees. Currently the industry is continuing with little or no innovations. The machines are still running by diesel driven engines. The prices of products made out of bristle fibre, mattresses, and yarns remain stagnated.

This case reveals the most important theme with respect to institutional context and entrepreneurship. Although informal institutions are tending to create opportunities than discover opportunities, this case is a deviation from that proposition. Four brothers at *Hath-pokuna* discovered an opportunity instead of creation an opportunity. The reason for such a creation may be identifying gaps in current business and matching those gaps with the environment. Similar argument had been put forward by Kodituwakku and Rosa (2002) stating 'entrepreneurship is matching opportunities with the environment'. Further, it demonstrated a survival strategy for traditional non-innovative industry. The industry is non-innovative (still using very old diesel

engines) but could make profits by exploiting resources in the rural environment (labour and land). This case also indicates the lapse of formal institutions in uplifting traditional industries. As well, this reveals that the development of infrastructure has no effect on these industries. Entrepreneurs of *Hath-pokuna* only exploited rural context to reduce the cost of production rather than seeking subsequent opportunities similar to urban entrepreneurs.

Case 8: This is a case of producing milled raw-rice for external market. This industry is located in *Degoda-thurawa* and doing the paddy milling for external market. The mill is owned by a youth of 30 years. He has closely watched new developments since the land was located in the forest reserve and decided to take advantage of the transformer installed in the bare land in the *Ihalagama* mountain (voltage drops along with the distance from transformer). The owner was a son of a businessman who owns the largest boutique in the area. When he was schooling, he helped to his father and gained a business experience. He has gone to the *Niyanda-wila* junior school and went for advanced level to the town. Soon after schooling, in 2005, he started the business with four employees. He employed eight persons for the industry and installed electricity driven machines. His main product is raw-rice and the target market is not common because the people in North Western province consume par-boiled rice and occasionally use raw-rice. He purchases local paddy from the nearby area during the local harvesting season and go for distant areas (e.g. *Anuradhapura* and *Pollonnaruwa*) when the price of paddy is increasing in the local areas.

Reason for establishing the business in *Degoda-thurawa* includes; (i). less demand for environmental restrictions, (ii). availability of uninterrupted electricity (closer to a transformer), (iii). cheap labor (not stated but found below Rs. 800 per day against Rs.1000-1200 in the town), (iv). niche market for raw-rice (did not disclose), he stayed at his home next to the mill (most mill owners avoid smelly and dusty environment of paddy mills) and (v). less demand for water for raw rice (no boiling is required for raw-rice but drying is important to reduce the volume of broken rice). Still he is continuing the business and runs the mill continuously. The major financial support comes from his father and formal banks.

5. Findings and Discussion

Analysis of institutional contexts, as shown in table 2 and table 3, reveals that the institutions in the rural setting are predominantly informal and built upon blood relationship. In the village level, there are only two surnames (*Tennakoon Mudiyansele* and *Dissanayake Mudiyansele*) which indicates the strength of blood relationship. Therefore, more than 178 families are highly interrelated and share available resources among them. Table 2 and table 3 show the difference between the rural and urban contexts along with several dimensions affecting on the entrepreneurial process such as human capital, physical capital, stock of information and etc. Accordingly, social networks density is high but homogeneous in rural context and low and heterogeneous in the urban context. One business owner said that 'They cannot borrow over 1000 rupees from any villager in the off season'. Information in the highly dense network is redundant while most of the capable youth study in the urban and employed in places other than village. Therefore, rural context is poor both in network content, new information and human capital in broader sense. In contrast, rural entrepreneurs are migrating to various parts of the Island mainly to towns and settled there with the purpose of doing business. They have identified opportunities before coming to the town and built networks according to the business requirements they engaged or intended to engage in. Therefore, business networks are highly important for them and very sensitive to the macro-economic environment and fiscal policies. Unlike rural context, social network densities are very low but high in business networks in the urban context. The main constituents of the business network include: bank manager,

income tax officials, sales representatives of companies and politicians. There are many groups organized according to the business that they are engaging in.

Table 2: Analysis of Contexts

Dimension of Context	Context	
	Rural	Urban
Stock of Resources		
Human capital	Low	High
Physical capital	Low	High
Stock of information	Redundant	New
Strength of Institutions		
Informal Institutions	Strong; self-evolved over centuries	Weak; Evolved over less than 20 years
Formal institutions	Weak	Strong
Social Networks		
Density	High; homogeneous	Low; heterogeneous
Content	Low in value	High in value
Governance mechanisms	Kith and Kin and blood relationship	Clustered on business interests

Table 3: Analysis across cases relating to Entrepreneurial Context

Cases	Main Livelihood	No. of opportunities exploited	Context			
			Rural		Urban	
			Nature of Individual	Nature of opportunity	Nature of Individual	Nature of opportunity
			Novice	Less innovative	Serial entrepreneurs	Innovative
Case 1	Business	11	-	-	Yes	Yes
Case 2	Business	5	-	-	Yes	Yes
Case 3	Business	7	-	-	Yes	Yes
Case 4	Business	3	-	-	Yes	No
Case 5	Farming	2	Yes	Yes	-	-
Case 6	Farming	2	Yes	Yes	-	-
Case 7	Business	1	Yes	Yes	-	-
Case 8	Business	1	Yes	No	-	-

According to the case information, it shows that entrepreneurs in urban level have exploited more than one opportunity and the average is around five. Currently these entrepreneurs are managing at least three independent businesses (portfolio of businesses). In contrast, no serial or portfolio businesses were found in the rural setting and however most of the business oriented farmer families are carrying out at least two farming activities (Paddy and other crops). All small businesses in the rural setting have exploited non-innovative opportunities and have rooted those businesses in agriculture.

One important finding of the analysis is the variation of density of social networks. Information and resources are flowing from two different networks: homogeneous, dense social networks (rural) and heterogeneous, less dense business networks (Urban). Quality of human resources in terms of business experience is low in rural since majority of educated youth is

settled in the urban or works for wage employment. The more experienced entrepreneurs in the urban may learn to take calculated risk while rural entrepreneurs are settled to adverse uncertainty due to lack of business experience. This behaviour may attribute to the dominance of informal institutions in the rural setting. Moreover, rural setting is organized to create opportunities since they are not capable of calculating risk of an identified opportunity. Creating opportunities takes longer time as entrepreneurs attempting to match outcomes with similar business entries which also consistent with Alvarez (2007). As indicated in literature review, identifying opportunities under risk and creating opportunity under uncertainty are two different concepts (Knight, 1921). The findings of this study confirm that the influence of informal institutional context may have negative effect on the number of opportunities created or identified. Further influence of informal institutional context may have negative effect on innovativeness.

As per the case analysis relating to two institutional contexts, entrepreneurs differ in number of opportunities that had been identified and also with their innovativeness. The average number of opportunities in selected cases is five. The entrepreneur who exploited maximum number of opportunities is eleven and the minimum number is three. In contrast, entrepreneurs in the rural context are novices (exploit one or two opportunities) while those in the urban context are habitual or serial entrepreneurs. This difference may explain the influence of institutional context on the number of exploited opportunities under risk and uncertainty. This difference is also reflected from the innovativeness of opportunities. Ucbasaran et al., (2006) assumes that innovativeness is proxy to wealth creating ability of opportunity. This ability may reflect from the return on investment. Except *Hath-pokuna* and raw-rice cases (cases seven and eight) investment on opportunities identified and exploited is very low.

Surprisingly, case seven and eight have exploited innovative opportunities even though they are novices (exploit only one opportunity). Entrepreneurs who exploited more than one opportunities (cases five and six) are non-innovative. This implies that rural environment is not confine only to non-innovative opportunities and they could be innovative. This evidence does not support the idea of informal rural context creates less innovative opportunities.

Evidence for uncertainty avoidance is the less exposure to business experience and depending on limited set of raw materials and semi-skilled labour. The two innovative entrepreneurs in the rural are using local raw material (for example, coconut husks and paddy) and local labour specially the family labour which may have kin relationship with the entrepreneur. Although case five and eight use paddy as their raw material, case eight produce to external market while case five attempts to capitalize on local market. However, both are exploited local context in different ways to avoid uncertainty. Case five uses family labour for his venture while case eight is about processing raw rice (instead of par-boiled rice) as a solution for water scarcity. In terms of wealth creating capability, both cases didn't provide evidences for rural entrepreneurs are seeking less innovative opportunities.

Cross case analysis between urban and rural contexts (Table 3) give rise to develop a theory of influence of institutional context on entrepreneurial process, particularly opportunity seeking behaviour. All cases in rural context are not influenced by macro-economic or fiscal policies other than market forces. Labour laws (Employee Provident Fund, working hours, etc) are not applicable to labour with family relationships. Export and import rules and regulations (which are significant in macro-economic policy environment) do not have an influence on rural small businesses. However, urban entrepreneurs are very sensitive to these policy environments since profit margins of businesses of all four cases are depended upon the tax policy, labour policy and exchange control procedures of the local government.

According to the overview of the cases, this study explored that density of social network is a factor which prevent majority of rural entrepreneurs from discovering innovative

opportunities. While high density of networks protects entrepreneurs from the challenges created by formal institutions as well as from taking risk to exploit more subsequent opportunities. As a result, high density of social network had been created inertia for entrepreneurial process, particularly in opportunity seeking behaviour.

6. Conclusions

This study has addressed the question raised at the outset, how does institutional context influence on entrepreneurial process of small businesses? This study also shows that variation in distribution of innovative small businesses is a function of institutional context. According to findings, this variation arises as a resultant force emanating from the interaction between formal and informal institutions. Even though rural environment is generally resource constrained, this study shows that how innovative opportunities could emerged within these low-resources environment by exploiting situational advantages (e.g. expansion of land, low cost of labour; relaxed environment rigidities).

This study also shows that the macroeconomic policies do not have a significant effect on rural entrepreneurship irrespective of resource endowment over last six decades. Then it is important to develop two-prong policy initiatives, one focussing on rural context and the other on urban context which are governed by rules and regulations, policies and other formal institutions. Even though improving stock of resources in rural sector is not easy by altering present approach to rural entrepreneurship and paying specific attention to inertia in the rural environment, rural entrepreneurship can be made the driving force for the economic growth of the country. This study signals the importance of paying attention to context when adopting empirical findings of research conducted in different countries and environments.

Limitations of this study are centred on number of cases and the locations. These limitations are unavoidable in qualitative research, particularly, when attempting to develop new theories. This study was conducted in a zone climatically intermediate, in a township which won awards for Best Township, and in a poverty stricken village located under harsh environment. While largely qualitative in nature, findings of this study provide useful insight into the nature of entrepreneurship located in rural and urban environments in the North-Western province. These findings could be extended to the country which is mainly constituted of rural and urban settings. Even though all provinces in Sri Lanka are not climatically intermediate, rural and urban setting are generic feature of the Island. This facet may reduce the threat for generalizability of the study findings.

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