

6-13-2015

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### Recommended Citation

Lee, Chong Kyoong; Lumpkin, G.T.; and Bangar, R.R. (2015) "THE IMPACT OF STIGMA OF FAILURE ON SOCIAL ENTREPRENEURSHIP ENTRY DECISIONS: A CROSS-COUNTRY ANALYSIS," *Frontiers of Entrepreneurship Research*: Vol. 35 : Iss. 15 , Article 1.

Available at: <http://digitalknowledge.babson.edu/fer/vol35/iss15/1>

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# THE IMPACT OF STIGMA OF FAILURE ON SOCIAL ENTREPRENEURSHIP ENTRY DECISIONS: A CROSS-COUNTRY ANALYSIS



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## ABSTRACT

How does the stigma of failure affect social entrepreneurship entry decisions around the world? Informed by a real options logic, we hypothesize that the stigma of failure decreases the value of the option to defer social entrepreneurship entry. Results of a multi-level analysis of 50,349 individuals from 22 countries suggests that the stigma of failure is positively associated with social entrepreneurship entry decisions. Further, the impact of failure stigma is more prominent in low stigma environments. Lastly, the stigma of failure affects revenue-generating social entrepreneurship, but not NGO-type social entrepreneurship. This study is the first to examine the impact of stigma of failure on social entrepreneurship entry decisions.

## INTRODUCTION

Social entrepreneurship (SE) is widely viewed as an effective approach to solving social problems. Although the prevalence of SE varies substantially across countries (Lepoutre, Justo, Terjesen, & Bosma, 2013), we know little about the factors that induce national differences in SE activity (Short, Moss, & Lumpkin, 2009). A key factor in understanding different SE levels across countries is to address who becomes a social entrepreneur, and under what circumstances. Douglas and Shepherd (2000) argue that individuals are basically rational by attempting utility maximizing calculations when making a decision such as career choices. One such calculation involves evaluating the influence of institutional forces on the entrepreneurial entry decision, and whether there are incentives or disincentives associated with the expected outcome of entrepreneurial activity (Baumol, 1990). Hence, it is important to consider how institutional forces affects different types of entrepreneurship and influences individuals' entrepreneurial career choices.

One force that has been shown to affect entrepreneurial entry decisions is the stigma of failure (Damaraju, Barney, & Dess, 2010). Stigma refers to a mark of disgrace that occurs, in certain contexts, when people who go against societal expectations are devalued (Goffman, 2009). In an entrepreneurship context, it is expected that entrepreneurs will maintain the survival and viability of their venture (Lee, Yamakawa, Peng, & Barney, 2011). If entrepreneurs declare bankruptcy, it is evidence of failure and may be marked with disgrace (Landier, 2005). Accordingly, the stigma associated with bankruptcy is widely used as a key indicator of failure. The stigma of bankruptcy can cause emotional costs and financial sanctions for future actions (Shepherd Wiklund & Haynie, 2009), and loss of one's social network (Sutton and Callahan, 1987).

The level of stigma accorded to failed entrepreneurs differs by country. In Silicon Valley, business failure is often considered a stepping stone for future success; in Japan, entrepreneurial failure is a matter of shame to the extent that top managers of failed firms may commit suicide

to avoid entailing stigma (Tezuka, 1996). Although all entrepreneurs are interested in creating successful ventures, most ventures fail and many of them declare bankruptcy (Lee et al., 2011). Social ventures are no exception because they can fail by generating insufficient economic value for operations leading to bankruptcy. Whether the stigma associated with entrepreneurial failure influences the entry decisions of social entrepreneurs, however, is not known. This paper contributes to social entrepreneurship research by examining the stigma of failure in an SE context. As such, it responds to recent calls for consideration of context in examining social entrepreneurial behavior (Short et al., 2009).

### HYPOTHESIS DEVELOPMENT

In contrast to neoclassical investment theory, real options theory focuses on actual business applications of behavioral decisions under uncertainty (A. Dixit, 1989; Kogut & Kulatilaka, 2001). Real option theory predicts that uncertainty will affect entrepreneurial entry when the investment is irreversible (Pindyck, 1991). Because uncertainty is a key feature of entrepreneurship (Knight, 1921) and starting a venture requires irreversible investments (Campbell, 1992), a real options lens can be a useful approach for understanding entrepreneurial entry decisions. At the threshold of founding a new firm, an individual has different types of real options, such as the option to defer, the option to abandon, and the option to alter inputs (Kester, 1984). Among these options, researchers have focused on the option to defer in examining entrepreneurial entry decisions (O'Brien et al., 2003). In entrepreneurship contexts, the value of the option to defer increases (making entrepreneurial entry less likely) when outcome uncertainty increases, because it allows individuals to acquire new information before committing resources (O'Brien et al., 2003).

The stigma of failure adds financial and emotional costs to the potential downside outcome in addition to loss of sunk cost (Shepherd et al., 2009), thus increasing outcome uncertainty. Accordingly, individuals will defer entrepreneurial entry to acquire more information before committing (Armour & Cumming, 2008). However, in the presence of stigma, the option to defer engaging in SE has lower value than engaging in commercial entrepreneurship (CE) for the following two reasons. First, the negative impact of stigma associated with entrepreneurial failure is lower for SE failure than CE failure. In contrast to CE, SE explicitly emphasizes social value creation over economic value creation. Just as we do not blame firemen who may have failed their mission because of their devotion to society, failed SE would not be blamed at the same level as failed CE. Second, irreversible investments in SE are relatively smaller than for CE. This is because social entrepreneurs can often be natural partners with governments, which can provide tangible and intangible resource support (Evans, 1996; Korosec & Berman, 2006). The value of the option to defer falls when irreversible investment are smaller (Crifo and Sami, 2008); that is, the option value of the deferring SE entry is lower than CE. Accordingly, we hypothesize:

*Hypothesis 1: The stigma of entrepreneurial failure at the national level is positively associated with the likelihood of individuals' engagement in social entrepreneurship.*

At the same time, we propose that the relationship between the stigma of entrepreneurial failure and SE entry decisions differs by the level of stigma in countries. First, in countries with higher levels of stigma, the relative benefits from engaging in SE may not exceed the penalty due to the stigma of failure. Second, higher stigma of failure decreases total entrepreneurial activities (Armour & Cumming, 2008; Landier, 2005), because outcome uncertainty is greater in high stigma environments than in low stigma environments. In other words, there is a smaller pool of individuals who can reconsider career choices from CE to SE in countries with higher stigma than

in countries with lower stigma. Accordingly, the option of deferring SE entry will be less valuable in high stigma environments than in low stigma environments. Thus, we hypothesize:

*Hypothesis 2: The relationship between the stigma of entrepreneurial failure and the likelihood of individuals' engagement in SE is more prominent in low stigma environments than in high stigma environments.*

Social ventures may differ with respect to their dependence on the market for generating revenues (Lepoutre et al., 2013). Austin et al. (2006) state that reliance on the market mechanism is an important identifier to differentiate SE. Accordingly, we distinguish two types of SE based on utilization of market mechanisms: NGO-types and revenue-generating types of SE. In contrast to revenue-generating SE, NGO-type SE places less emphasis on creating economic value. Hence, unless individuals are solely motivated to create social value, NGO-type SE will not be attractive to individuals even though they attempt to avoid the stigma of failure. However, the option to engage in revenue-generating type SE can be more valuable under high stigma of failure because it allows for creating economic value similarly to CE and has less outcome uncertainty due to lower stigma of failure and/or availability of government subsidies. Thus, we hypothesize:

*Hypothesis 3: The stigma of entrepreneurial failure at the national level is positively associated with the likelihood of individuals' engagement in revenue-generating social entrepreneurship, but not with NGO-type social entrepreneurship.*

## METHOD

### Data

To test the impact of country-level stigma on individual-level SE-entry decisions, we perform multi-level logistic regression analysis. The data on the main dependent variable - individuals' engagement in SE activity - as well as individual level controls is collected from the Global Entrepreneurship Monitor (GEM) Adult Population Survey. The GEM manual and Lepoutre et al. (2013) list the procedures used to collect the best possible randomly-selected, standardized, and representative data. Although the GEM survey was conducted in 49 countries, we exclude those observations for which all required data for the analysis was unavailable. Stigma of bankruptcy data was obtained from the survey collected by the European Commission. The data on accessibility of credit information is downloaded from the World Bank Doing-Business database. Other country-level controls such as GDP PPP, and GDP growth are obtained from the World Bank database; data on Hofstede's power-distance measure was downloaded from <http://geert-hofstede.com>. Our final sample includes 50,349 observations of individuals from 22 countries.

### Measures

**Dependent Variables:** Our main dependent variable is the individuals' engagement in SE activity. This dependent variable is a binary variable coded 1 if the individual is engaged in establishing social enterprises (nascent social entrepreneur) or has been operating social enterprises for less than 48 months (operating social entrepreneur), otherwise the dependent variable is coded as 0. In particular, GEM asks survey participants the following question: "Are you, alone or with others, currently trying to start or currently owning and managing any kind of activity, organization or initiative that has a particularly social, environmental or community objective?" The definition of SE adopted by GEM is aligned with a widely accepted definition of SE (Mair & Marti, 2006). To assess SE type, we use two variables taken from the GEM APS survey. Revenue-generating SE is coded as 1 if the individual engages in SE that generates economic value, and is coded as zero

otherwise. NGO-type SE is assessed by a binary variable which is coded as 1 if the individual is engaged in non-profit activity which utilizes innovative solutions, and 0 otherwise.

**Independent Variable:** The main independent variable is the stigma of failure. Prior research uses the stigma associated with bankruptcy (Simmons, Wiklund & Levie, 2014), to measure the stigma of failure. Stigma of bankruptcy is constructed from the survey data collected by the European Commission which examined the attitudes towards entrepreneurship in the European Union. Although its focus is the European Union, it also provides data from non-European countries such as South Korea, China, Brazil, and the United States for comparative analysis. The stigma of bankruptcy variable measures the percentage of responses to the statement, “people who have started their own business and have failed should be given a second chance.” For ease of interpreting results we reversed the sign of the stigma of bankruptcy variable; thus, a high value of stigma indicates greater sanctions on failed entrepreneur.

**Control Variables:** Consistent with previous research, we use individual-level control variables from GEM survey data to determine the prevalence of SE. These controls, most of which are known determinates of SE activity, include age, gender and level of education (Estrin, Mickiewicz & Stephan, 2013), as well as financial, social and human capital (Shepherd, Williams & Patzelt, 2015). Country wealth measured by per capita GDP at purchasing power parity, has been shown to be associated with the individuals’ engagement in SE activity (Lepoutres et al., 2013). This is related to the GDP growth variable which is an additional control variable in our analysis. Further, government expenditures on social welfare are also expected to affect the prevalence of SE (Stephan, Uhlaner & Stride, 2014). Lastly, we control also for country-level informal institutions, such as national cultural factors, by including Hofstede’s power distance as we expect a society with higher power distance to have lower prevalence of SE. As a robustness check, to ensure that stigma provides information about SE prevalence over and above the information provided by other formal country-level institutional mechanisms, we also control for the accessibility of credit information which explores two sets of issues: the strength of credit reporting system, and the effectiveness of collateral and bankruptcy laws in facilitating lending.

### Statistical Analysis

We test the effect of country-level stigma on individual-level SE entry decisions by using multi-level logistic regression analysis. As our data is nested within country-level data, single-level regression will not take into account the average variation between countries. In addition, single-level regression can produce biased estimates due to ignoring the correlation between observations within the same countries, and may also face problems of external validity. Due to the nature of our data, multi-level logit regression appears to be most appropriate model (Guo & Zhao, 2000). We use the Stata command `xtmelogit` for the analysis. This command has a default value of one integration point, which is equivalent to using the Laplace approximation, which, in turn, could severely bias the estimates. Hence, we specify the option of 40 quadrature points to ensure better accuracy. The estimates are similar after increasing the quadrature points boosting our confidence in our methods. To further, confirm our findings on the suitability of multi-level techniques, we calculate the intra-class correlation (ICC) estimates (ICC = 9.2%), which indicates substantial country-level effects (Bleise, 2000).

## RESULTS

The correlation coefficients between the key variables used in the analysis provides preliminary evidence consistent with our main hypothesis of a positive link between the stigma of failure in a

country and the probability of SE in that country. In particular, we find a significant and positive correlation between the stigma of failure and the probability of individuals' engagement in SE; we also find significant correlation between the country-level control variables and the likelihood of individuals' engagement in SE. To control for these multiple correlations we use multi-level regression models.

Results of our hypothesis test support the Hypothesis 1 claim of a positive link between stigma of failure and SE entry decisions. The common dependent variable for all the multi-level logit regression models is the variable measuring SE entry decision. First we confirm that most of the individual-level and country-level control variables are significant predictors for the social entrepreneurship entry. Second, we add the stigma of failure, which is the main determinant variable, to the regression model along with other control variables. We find a statistically significant positive association ( $\beta=1.04$ ,  $p<0.01$ ) between SE entry and the stigma of failure.

As a robustness check for Hypothesis 1, we address concerns about whether our results are driven by the country-level institutional factor of access to credit. The results of this model provide further support to Hypothesis 1, and we find a similar statistically significant positive association ( $\beta=1.08$ ,  $p<0.001$ ) between SE entry and stigma. We also find that access to credit is a statistically significant predictor of social entrepreneurship entry, but including this variable in the model does not substantially alter the relationship between SE entry and stigma.

Next, we tested Hypothesis 2 by median-splitting the sample into high stigma (stigma > 19.5) and low stigma countries to understand the differential strength of stigma on the SE entry decision. We find that stigma continues to have a positive association with the SE entry decision in both low level stigma countries ( $\beta=1.18$ ,  $p<0.01$ ), and in high level stigma countries ( $\beta=1.04$ ,  $p=0.068$ ). However, we find that the strength of the positive association between stigma and the SE entry decision is significantly higher in low stigma countries than in high stigma countries ( $z=-2.28$ ,  $p=0.023$ ). These results provide support for Hypothesis 2.

To test Hypothesis 3, we analyzed the differential effects of stigma on different types of SE—NGO and revenue-generating. We find a statistically significant positive association ( $\beta=1.04$ ,  $p<0.01$ ) between stigma and revenue-generating SE, but do not find a significant relationship between stigma and NGO-type SE ( $\beta=1.15$ ,  $p>0.1$ ) indicating support for Hypothesis 3.

In all these sets of multi-level regression, we also examine the Variance Inflation Factor (VIF) statistics to control the possibility of strong multicollinearity influencing our results. We find that all VIF scores are below 10, suggesting that multicollinearity is not a concern for our analysis.

## DISCUSSION AND IMPLICATIONS

This study stands to contribute in three key ways. First, the study finds that the stigma of failure is positively associated with the likelihood of individuals' engagement in SE suggesting that stigma does impact the social entrepreneurship entry decision. Thus, this study contributes to recent calls for consideration of context in examining social entrepreneurial behavior (Short et al., 2009; Zahra & Wright, 2011). In particular, this study fills a research gap in the conversation regarding determinants of SE entry decisions by being the first we know of to examine the stigma of failure.

Second, our analysis indicates that stigma of failure has different effects depending on the extent to which social entrepreneurs employ market-based mechanisms. In particular, the stigma of failure has a positive association with entry decisions for revenue-generating type SE, whereas

it has no association with entry decisions for NGO-type SE. Moreover, this study finds that government activism is positively associated with revenue-generating SE, but not with NGO-type SE. These findings infer that revenue-generating SE can be an attractive career choice to people attempting to avoid the stigma of failure. Academia accepts the broad definition of SE that includes the NGO-type of SE (Mair & Marti, 2006), but this study suggests that national contexts can influence SE entry decision differently depending on whether SE utilizes market mechanisms.

Third, this paper contributes to real options theory by elaborating the relationship between institutional and outcome uncertainty. By examining the impact of stigma, this study reveals how likely SE activity is to emerge in a country, and whether the links between CE and SE can be expected to support or impede the likelihood of addressing social problems with entrepreneurial solutions. Further, this study highlights the importance of individuals' discretion over their career choices in electing to pursue either CE or SE given institutional factors. This dynamic of career choice merits more careful research in the future. Consequently, this study underscores that SE researchers need to look at the impact of country-level predictors on dynamism of individuals' career choices between commercial and social entrepreneurship entry decisions simultaneously and that real option theory can be a proper tool to examine the entrepreneurial entry decisions.

#### LIMITATION

This study is not without limitations. The first limitation is related to the generalizability of our data. Although we account for over 50,000 individuals from 22 countries, middle and high-income countries tend to be overrepresented in our sample compared to low-income countries. Thus, the variation in institutions is somewhat limited in our study. Moreover, the data for individuals' engagement in SE is available for only one year. We hope our analysis will be repeated on a larger sample of countries and more years of data. Second, although the initial screening question mentions social, community and environmental objectives, the examples of environmental entrepreneurship are omitted in the questionnaire. As such, our study may constitute an under-representation of environmental SE. Third, social enterprises might also be created from outside of home countries. This type of international SE is not represented in our data.

#### CONCLUSION

Despite the limitations of this study, the use of multi-level regressions, and control variables to ensure robustness, enhance our confidence in the findings of this study. The study shows that the stigma of failure is positively associated with SE entry decision, and also that the impact of stigma is more prominent in low stigma environments than in high stigma environments. Further, we find that stigma affects entry decisions only in revenue-generating SE, but not in NGO-type SE. Since our research addresses an early inquiry regarding institutions associated with entrepreneurial failure, we hope that our study will inspire further studies of this important topic.

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