

In Search of the Meaning of Entrepreneurship

Robert F. Hébert
Albert N. Link

All perception is no doubt an act of interpretation, of finding in, or injecting into sense-impressions a meaning, the collating with them of numberless memories of experience, the seeing in them of *possibilities*. This is in its own degree an act of origination. This same activity of thought, but at an enormously enriched, intensified and out-ranging degree, is what marks the creative writer, composer or theoretician, and it is what marks the entrepreneur.

G. L. S. SHACKLE

ABSTRACT. This paper is an attempt to build a bridge between the popular and the academic usage of the terms *entrepreneur* and *entrepreneurship*, and to identify the raw materials needed to construct an interpretive framework capable of illuminating the nature of entrepreneurship and its role in economic theory. We review briefly the contributions made to this topic by Cantillon, Schumpeter, Schultz and Kirzner. We advance a 'synthetic' definition of the entrepreneur as *someone who specializes in taking responsibility for and making judgemental decisions that affect the location, the form, and the use of goods, resources, or institutions*. We then conclude with some observations on the basic choice confronting economics regarding the place of entrepreneurship in economic analysis.

Final version accepted on July 1, 1988

Department of Economics
Auburn University
Auburn, AL 36849
U.S.A.

and

Department of Economics
University of North Carolina at Greensboro
Greensboro, NC 27412
U.S.A.

I. The entrepreneur: catchword or crucial concept?

The terms *entrepreneur* and *entrepreneurship* are common to the vocabularies of most people today, and the topic occupies a prominent position on the research agendas of scholars from a variety of disciplines including anthropology, history, management, psychology, sociology, and economics. Academic courses in entrepreneurship are now found at undergraduate and graduate levels in many business schools. Centers for the study of entrepreneurship currently operate on many university campuses, and endowed chairs have sprung up across the land to teach this important topic to an eager assortment of future executives.

Entrepreneurship usually has a special meaning in this context. It pertains to the actions of a risk taker, a creative venturer into a new business or the one who revives an existing business. Steven Jobs (Apple Computers) and Donald Burrs (People Express) exemplify such persons. According to sociological and psycho-management research, such people are usually first-born children, generally male, college-educated, in their thirties at the time of their first significant venture, highly motivated, creative, energetic, and willing to accept risk (Hisrich, 1986). Provided they succeed, such individuals enjoy a "mythical status in America. Symbols of individualism, drive, and intuition, they are the embodiment of our romantic view of capitalism" (Ehrlich, 1986, p. 33). According to David Gumpert, entrepreneurship "is the stuff of which American heroes are made" (1986, p. 32).

Because neither entrepreneurs nor entrepreneurship are new concepts of human experience, it is legitimate to ask: Why this newfound popularization, even idolization, of the entrepreneur?

Several explanations are plausible. Each appears to be colored in some measure by the fact that the U.S. economy, like the economies of most industrialized nations, seems to have entered a period of secular decline. The average annual rate of labor productivity growth in the United States fell from 3.3 percent between 1948 and 1965 to 2.3 percent between 1965 and 1973, and again to 1.2 percent between 1973 and 1978. Current estimates show little, if any, improvement since then (Link, 1987). There are many reasons for this persistent slowdown, but corporate management has been singled out for particularly sharp criticism. Writing in the *Harvard Business Review*, Robert Hayes and William Abernathy gave expression to the current economic malaise:

During the past several years American business has experienced a marked deterioration of competitive vigor and a growing unease about its overall economic well being. . . . More troubling still, American managers themselves often admit the charge with, at most, a rhetorical shrug of their shoulders (1980, pp. 67–68).

At the onset of the 1980s, Burton Klein (1979) decried the decline in productivity in America and equated it with a deterioration of entrepreneurship. He claimed that the U.S. economy was in the process of changing from a dynamic to a static economy, thereby losing its capacity to generate new technical and organizational alternatives to the status quo. Academicians and policymakers have responded to waning productivity growth and increased global competition by calling for a revival of entrepreneurship. Ruben Mettler's argument is typical of many others:

The challenge for managers of large and small companies is to learn how to develop (or buy) technology that is best for their specific purposes, how to control the cost of using it, and how to finance it, all while earning enough profit to continue to invest and compete and grow in world markets on a sustained basis. In short, the challenge is to be an entrepreneur (1986, p. 518).

The issues at hand are so vital that presidential politics have also been brought to bear. A 1985 report, *State of Small Business: A Report of the President*, states that small entrepreneurial enterprises accounted for more than 50 percent of the new employment opportunities in the economy since 1982. President Reagan followed up the same theme in his 1985 address to the nation in

which he referred to the present decade as the "Age of the Entrepreneur." The intellectual focus of supply-side economics aims at removing barriers against and erecting incentives to engage in entrepreneurial activity.

Contemporary writers have been quick to capitalize on the popular mood. A flood of recent books on the entrepreneur testifies to the vibrance of the entrepreneurial spirit. The popular press has churned out such provocative recent works as A. David Silver's *Entrepreneurial Megabucks: The 100 Greatest Entrepreneurs of the Last Twenty-Five Years*; Steven Brandt's *Entrepreneurship: The Ten Commandments for Building a Growth Company*; Peter Drucker's *Innovation and Entrepreneurship: Practices and Principles*; and Victor Kiam's *Going For It! How to Succeed as an Entrepreneur*.

Popular writers of the day usually posit their own definitions and conceptualizations of the entrepreneur. Sometimes these conceptualizations are historically based and sometimes they are not. We might expect academics and professional economists, who are generally more aware of historical precedent, to follow a different pattern. Yet the historical record on the nature and goals of the entrepreneur is so diverse, it has failed to yield a clearcut and unambiguous operational concept of entrepreneurship. This paper is an attempt to bridge the gap between popular and academic usage by exposing the raw materials needed to construct an interpretive framework capable of illuminating the nature of entrepreneurship and its role in economic theory.¹

II. An overview of economists' views

The history of economics holds diverse opinions on the nature and role of the entrepreneur. Contemporary economic theory recognizes entrepreneurship as an independent factor of production on a more-or-less equal footing with land, labor, and capital. The distinction between manager and entrepreneur is now firmly drawn. However, the ultimate place of risk and uncertainty in the theory of entrepreneurship remains ambiguous, leaving profit theory in a kind of analytical limbo. The exact relationship between entrepreneurship and economic development is also a matter of ongoing debate.

Throughout intellectual history as we know it,

the entrepreneur has worn many faces and played many roles. We have identified at least twelve distinct themes in the economic literature:

1. *The entrepreneur is the person who assumes the risk associated with uncertainty.*
2. *The entrepreneur is the person who supplies financial capital.*
3. *The entrepreneur is an innovator.*
4. *The entrepreneur is a decision maker.*
5. *The entrepreneur is an industrial leader.*
6. *The entrepreneur is a manager or superintendent.*
7. *The entrepreneur is an organizer and coordinator of economic resources.*
8. *The entrepreneur is the owner of an enterprise.*
9. *The entrepreneur is an employer of factors of production.*
10. *The entrepreneur is a contractor.*
11. *The entrepreneur is an arbitrageur.*
12. *The entrepreneur is an allocator of resources among alternative uses.*

Theories of entrepreneurship may be either static or dynamic, but only dynamic theories of entrepreneurship have any significant operational meaning. In a static world there is neither change nor uncertainty. The entrepreneur's role in a static state could not be anything more than what is implied above in statements 2, 6, 8, or 9. In a static world the entrepreneur is a passive element because his actions merely constitute repetitions of past procedures and techniques already learned and implemented. Only in a dynamic world does the entrepreneur become a robust figure. A dynamic role is implied for the entrepreneur in statements 1, 3, 4, 5, 7, 10, 11, and 12.

Once we eliminate purely static notions of the subject, the taxonomy of entrepreneurial theories can be condensed into three major intellectual traditions, each tracing its origin to Richard Cantillon (c. 1680–1734). The following graphic matches these three intellectual branches of the subject with the major writers of each tradition.



These three traditions qualify loosely as the German Tradition (Thünen-Schumpeter), the Chicago Tradition (Knight-Schultz), and the

Austrian Tradition (Mises-Kirzner-Shackle). However, this classification requires certain *obiter dicta*. To begin with, the lines of connection are not as straightforward as the graphic suggests. The connections between Cantillon and J. H. von Thünen and between Thünen and Joseph Schumpeter are tenuous. We base the linkages here more on expository convenience than on historical fact. There is a certain logic of affiliation between Thünen and Schumpeter in that they shared a common language and intellectual heritage. But the connection between Thünen and Cantillon is somewhat contrived on the basis of a common emphasis rather than direct intellectual lineage.

Frank Knight (1921) did not openly acknowledge Cantillon as the progenitor of his own theory of entrepreneurship, but the filiation of the two theories is too strong to ignore. T. W. Schultz (1980), however, openly aligns his theory with Knight's. The connection between Ludwig von Mises and Israel Kirzner is also straightforward and unambiguous. G. L. S. Shackle appears as a parenthetical entry with the Austrians because his basic concept of the entrepreneur is Austrian, but he separates himself from them (and from all the writers in the graphic) by rejecting the equilibrium paradigm.

Despite its obvious oversimplifications, this classificatory scheme is useful for several purposes. It emphasizes, for example, that those writers who most advanced the subject of the entrepreneur did so in the context of economic dynamics, and within the equilibrium paradigm. Persistent themes in this literature emphasize perception, uncertainty, and innovation (or other special abilities). Some writers, such as Schumpeter, assert that the entrepreneur creates disequilibrium while others, such as Kirzner, argue that he restores equilibrium after some exogenous shock. But this is a subtle difference which is of minor import to the overall understanding of the entrepreneurial function in a dynamic economy. Schumpeter certainly recognized the prevalence of other forces in the economy that work to restore equilibrium.

Another common ground among the traditions set forth above is that each characterizes the entrepreneur in functional terms, probably because functional theories in economics are heuristically more appealing than theories based

on mere personalities. However, Schumpeter (1954) cited two reasons why a functional theory might not capture all of the entrepreneurial gains or losses known to business practice. In the first place, the entrepreneur who stands between the commodity and factor markets is better placed to exploit favorable situations — to capture certain “leftovers” or residuals. In the second place, whatever their nature in other respects, entrepreneurs’ gains will practically always bear some relation to monopolistic pricing.

We find the first of these arguments more compelling than the second, especially in view of Kirzner’s (1973) attempt to clarify the distinction between competition and monopoly. By Kirzner’s reasoning, true entrepreneurial gains have nothing to do with monopoly in its “proper” sense, which implies only that entry barriers exist. The problem of who has a legitimate claim to economic leftovers is, however, a thorny one that will, in our opinion, continue to plague the theory of entrepreneurship for some time to come.

The crucial role of the entrepreneur in economic theory was first and foremost recognized by Cantillon. He was the progenitor of the idea that subsequent economists sought to elaborate. We pause here to examine Cantillon’s original conception and follow with the embellishments of several other key writers on the subject.

A. Richard Cantillon

Early in the 18th century, Cantillon outlined the framework of a nascent market economy founded on individual property rights and based on economic interdependency, or what he called mutual “need and necessity.” In this early market economy, Cantillon recognized three classes of economic agents: (1) landowners, who are financially independent; (2) entrepreneurs, who engage in market exchanges at their own risk in order to make a profit; and (3) hirelings, who eschew active decision making in order to secure contractual guaranties of stable income (i.e., fixed wage contracts). Although Cantillon ostensibly placed the landowner at the top of the economic hierarchy, a close examination of his work reveals the entrepreneur as the central economic actor.

Cantillon’s entrepreneur is someone who engages in exchanges for profit; specifically, he exercises business judgements in the face of uncertainty. This uncertainty (of future sales prices for goods on their way to final consumption) is rather carefully circumscribed. As Cantillon describes it, entrepreneurs buy at a certain price to sell again at an uncertain price, with the difference being their profit or loss.

Cantillon stressed the *function*, not the personality of the entrepreneur. He generalized the function of the entrepreneur so that it embraced many different occupations and cut across production, distribution, and exchange. “The farmer,” Cantillon (1931, pp. 47–49) wrote, “is an entrepreneur who promises to pay to the landowner for his farm or land, a fixed sum of money without assurance of the profit he will derive from this enterprise.” As an entrepreneur-producer, the farmer decides how to allocate his land among various uses “without being able to foresee which of these will pay best.” He must contend with the vagaries of weather and demand, placing himself at risk. Cantillon concludes that no one “can foresee the number of births and deaths of the people in a state in the course of the year,” or the rise and decline of family spending, “and yet the price of the farmer’s produce depends naturally upon these unforeseen circumstances, and consequently he conducts the enterprise of his farm at an uncertainty.”

Cantillon broke with convention in emphasizing the economic function of the entrepreneur over his/her social status. Social standing is irrelevant to Cantillon’s notion of entrepreneurship. In fact, he went so far as to identify even beggars and robbers as entrepreneurs, provided they take chances (i.e., face economic uncertainty). Yet being an entrepreneur does not exclude one from being something else. Entrepreneurs and nonentrepreneurs alike are joined in reciprocal trade agreements with other market participants. Entrepreneurs, therefore, “become consumers and customers one in regard to the other,” and proportion themselves to their customers in accordance with the laws of supply and demand. Like every other market, the market for entrepreneurs will adjust to market exigencies. “If there are too many hatters” (Cantillon, 1931, p. 53) wrote, “for the

number of people who buy hats . . . , some who are least patronized must become bankrupt," whereas, "if they be too few it will be a profitable undertaking which will encourage new hatters to open shops . . . so it is that the entrepreneurs of all kinds adjust themselves to risks in a state."

Since the writings of Knight, it is customary in economics to distinguish between risk and uncertainty. Knight pointed out that some forms of risk can be mitigated by insurance. To be insurable, there must be a known probability distribution associated with risk, either because of large numbers of individuals exposed to risk or repeated exposures to the same risk by the same individual. Although we cannot credit Cantillon with this distinction, it is reasonably clear that the concept of uncertainty central to his analysis is not of the insurable kind. In Cantillon's world, not only is the information about the future unknown, it is also for the most part, unknowable. While insurance companies tend to underwrite losses from named perils that are calculated to occur with predictable frequency, they do not typically insure against errors in judgement. Yet Cantillon's entrepreneurs are constantly called upon to exercise their business judgement, and if they guess wrong, they must pay the price.

Cantillon argued that the origin of entrepreneurship lies in the lack of perfect foresight. Individuals cannot know the future and/or its impact on economic life. Cantillon did not, however, consider this lack of foresight a defect of the market system, rather he accepted it as part of the human condition. Uncertainty is a pervasive fact of everyday life, and those who must deal with it continually in their economic decisions are entrepreneurs. We believe that Cantillon's conception of the entrepreneur is extremely important to a proper understanding of the concept in economic analysis. But his view did not predominate, nor was it complete in itself. It was myopic in one important respect. Cantillon excluded the "Prince," the landlords, and certain laborers from uncertainty. Today we recognize that economic uncertainty is more pervasive than he allowed. Mises was correct when he asserted that "no proprietor of any means of production, whether they are represented in tangible goods or in money, remains untouched by the uncertainty of

the future" (1949, p. 253). Cantillon's notion of entrepreneurship needed to be widened, and eventually it was, first by Knight and later by Mises.

B. Joseph Schumpeter

Joseph Schumpeter unveiled his concept of the entrepreneur against the backdrop of economic development. To Schumpeter, development is a dynamic process, a disturbing of the economic status quo. He looked upon economic development not as a mere adjunct to the central body of orthodox economic theory, but as the basis for reinterpreting a vital process that had been crowded out of mainstream economic analysis by the static, general equilibrium approach. The entrepreneur is a key figure for Schumpeter because, quite simply, he is the *persona causa* of economic development.

Schumpeter combined ideas from Marx, Weber, and Walras along with insights from his Austrian forebears, Menger, Wieser, and, his teacher, Böhm-Bawerk. Rather than slavishly imitate the work of others, he melded these elements into something uniquely his own. With Marx he shared the views that economic processes are organic and that change comes from *within* the economic system, not merely from without. He also admired the blend of sociology and economics that comprised the theories of Marx and Weber. From Walras he borrowed the notion of the entrepreneur, but in place of the phantom-like figure of Walras' general equilibrium system, Schumpeter substituted a living, breathing entrepreneur of flesh and blood. Reflecting the Austrian economists' interest in disequilibrium processes, Schumpeter made the entrepreneur into a mechanism of economic change.

To Schumpeter, competition involved mainly the dynamic innovations of the entrepreneur. This view is most clearly and completely set forth in his *Theory of Economic Development*, published first in German in 1911, and in English two decades later. Schumpeter used the concept of equilibrium as Weber used the stationary state — for him it was a theoretical construct, a point of departure. He coined a phrase to describe this equilibrium state: "the circular flow of economic life." Its chief

characteristic is that economic life proceeds routinely on the basis of past experience; there are no forces evident for any change of the status quo. In this Schumpeterian system the production function is invariant, although factor substitution is possible within the limits of known technological horizons. The major task that must be performed in this state is "that of combining the two original factors of production, and this function is performed in every period mechanically as it were, of its own accord, without requiring a personal element distinguishable from superintendence and similar things" (1934, p. 45). In this artificial situation, the entrepreneur is a nonentity. "If we choose to call the manager or owner of a business 'entrepreneur,'" wrote Schumpeter (1934, pp. 45–46), then he would be an entrepreneur of the kind described by Walras, "without special function and without income of a special kind."

For Schumpeter, the circular flow is a mere foil. The really relevant problem, he wrote in *Capitalism, Socialism and Democracy* (1950, p. 84), is not how capitalism administers existing structures, but how it creates and destroys them. This process — what Schumpeter called "creative destruction" — is the essence of economic development. In other words, development is a *disturbance* of the circular flow. It occurs in industrial and commercial life, not in consumption. It is a process defined by the carrying out of new combinations in production. It is accomplished by the entrepreneur.

Schumpeter reduced his theory to three elemental and corresponding pairs of opposites: (1) the circular flow (i.e., tendency toward equilibrium) on the one hand versus a change in economic routine or data on the other; (2) statics versus dynamics; (3) entrepreneurship versus management. The first pair consists of two real processes; the second, two theoretical apparatuses; the third, two distinct types of conduct. The theory maintained that the essential function of the entrepreneur is distinct from that of capitalist, landowner, laborer, inventor. According to Schumpeter, the entrepreneur may be any and all of these things, but if he is, it is by coincidence rather than by nature of function. Nor is the entrepreneurial function, in principle, connected with the possession of wealth, even though "the accidental fact of the possession of wealth constitutes a practical advantage" (1934, p. 101). Moreover, entrepreneurs do not form a social

class, in the technical sense, although they come to be esteemed for their ability in a capitalist society.

Schumpeter admitted that the essential function of the entrepreneur is almost always mingled with other functions, but management, he asserted, does not elicit the truly distinctive role of the entrepreneur. "The function of superintendence in itself, constitutes no essential economic distinction," he declared (1934, p. 20). The function of making decisions is another matter, however. In Schumpeter's theory, the dynamic entrepreneur is the person who innovates, who makes 'new combinations' in production.

Leadership and innovation are not homogeneous traits. An aptitude for leadership stems in part from the use of knowledge, and knowledge has aspects of a public good. People of action who perceive and react to knowledge do so in various ways; each internalizes the public good in potentially a different way. The leader distances himself from the manager by virtue of his aptitude. According to Schumpeter, different aptitudes for the routine work of "static" management results merely in differential success at what *all* managers do, whereas different leadership aptitudes mean that "some are able to undertake uncertainties incident to what has not been done before; [indeed] . . . to overcome these difficulties incident to change of practice is the function of the entrepreneur" (1928, p. 380).

Schumpeter's influence on the theory of economic development has been enormous, touching even those who reject his theory outright. Ultimately, the appeal of Schumpeter's idea derives from its simplicity and its power. By attributing the fundamental nature of change to the innovator, Schumpeter established a basis for meaningful economic progress. The role of the entrepreneur in the growth economy is direct and unambiguous. According to Schumpeter, "[t]he carrying out of new combinations we call 'enterprise'; the individual whose function it is to carry them out we call 'entrepreneurs'" (1934, p. 74). Yet despite the importance of his contribution to economic development, the practical import of Schumpeter's theory has not revolutionized conventional microeconomic analysis. Moreover, the modifications of Schumpeter's theory have had mixed results. On the pragmatic side, Albert Hirschman has tried to bolster Schumpeter's perspective by emphasizing a cooperative component of entrepreneurship in

addition to the creative component. For Hirschman, an entrepreneur must be more than a creative rebel, he must also embody "the ability to engineer agreement among all interested parties, such as the inventor of the [new] process, the partner, the capitalist, the supplier of parts and services, the distributors, etc." (1958, p. 17). Like many theories developed in the aftermath of Schumpeter's performance, however, this added perspective is a complement to, rather than a substitute for, the basic theory.

C. T. W. Schultz

Nobel laureate T. W. Schultz has fashioned a theory of entrepreneurship rooted in the theory of human capital, which he helped to pioneer. Schultz finds in contemporary economic literature a persistent failure to see the rewards that accrue to those who bring about economic equilibration, especially as it occurs in certain nonmarket activities. He has criticized the standard concept and treatment of entrepreneurship on mainly four grounds (1975, p. 832): (1) the concept is usually restricted to businessmen, (2) it does not take into account the differences in allocative abilities among entrepreneurs, (3) the supply of entrepreneurship is not treated as a scarce resource, and (4) entrepreneurship is neglected whenever general equilibrium considerations dominate economic inquiry.

Schultz's contribution consists of two major advances. First, he redefined the concept of entrepreneurship as "the ability to deal with disequilibria," and extended the notion to non-market activities (e.g., household decisions, allocation of time, etc.) as well as market activities. Second, he has produced evidence on the effects of education on people's ability to perceive and react to disequilibria. Schultz argues that Schumpeter did not go far enough in his formulation of entrepreneurship. "Whether or not economic growth is deemed to be 'progress'," declares Schultz (1975, p. 832), "it is a process beset with various classes of disequilibria." And whereas Schumpeter's entrepreneur "creates developmental disequilibria," his function is not extended successfully to "all manner of other disequilibria," including laborers who are reallocating their labor services, students, housewives, and consumers who are reallocating their resources, mainly time.

Schultz (1980, p. 438) also contends that Schumpeter's entrepreneurs have become a decreasing part of the technological story in present-day society because of the growth of research and development in the public sector, a development that Schumpeter could not have anticipated. In point of fact, Schumpeter spent many pages in his *Capitalism, Socialism and Democracy* (3rd ed., 1950) explicitly lamenting the fact that the growth of bureaucracy dampens the pioneering and innovating spirit.

Schultz has been an ardent defender of the equilibrium method. He has argued that:

Unless we develop equilibrating models, the function of this particular ability [entrepreneurship] cannot be analyzed. Within such models, the function of entrepreneurship would be much extended and the supply of entrepreneurial ability would be treated as a scarce resource (1975, p. 843).

Schultz's theory of entrepreneurship attempts to discriminate between the disequilibria faced by firms, households, and individuals, so as to trace out supply functions for the useful ability to deal with disequilibria. Supply, in this sense, "depends upon the stock of a particular form of human capital at any point in time and on the costs and the rate at which the stock can be increased in response to the rewards derived from the services of these abilities" (1975, p. 834). Testing the effects of education in this connection, Schultz finds it to be a strong explanatory variable.

Schultz's approach to entrepreneurship is fully within the neoclassical tradition. In the neoclassical paradigm, each useful factor of production has an identifiable marginal product. Therefore, because entrepreneurial ability is a useful service, entrepreneurs must have an identifiable marginal product. It follows that there must exist a "market" for the service in the sense of normal supply and demand functions. Schultz takes the position that the value of entrepreneurial activity is a differential return to ability.

The substance of my argument is that disequilibria are inevitable in [a] dynamic economy. These disequilibria cannot be eliminated by law, by public policy, and surely not by rhetoric. A modern dynamic economy would fall apart were it not for the entrepreneurial actions of a wide array of human agents who reallocate their resources and thereby bring their part of the economy back into equilibrium. Every entrepreneurial decision to reallocate

resources entails risk. What entrepreneurs do has an economic value. This value accrues to them as a rent, i.e., a rent which is a reward for their entrepreneurial performance. This reward is *earned*. Although this reward for the entrepreneurship of most human agents is small, in the aggregate in a dynamic economy it accounts for a substantial part of the increases in national income. The concealment of this part in the growth of national income implies that entrepreneurs have not received their due in economics (1980, p. 443).

This human capital approach to entrepreneurship rejects the idea of entrepreneurial rewards as a return to risk. Schultz maintains that although risk is omnipresent in a dynamic economy, there is no exclusive connection between risk and entrepreneurial activity. In his words, "the bearing of risk is not a unique attribute of entrepreneurs. Whereas entrepreneurs assume risk, there also are people who are not entrepreneurs who assume risk" (1980, p. 441). This view is, of course, definitionally based. Because Schultz chooses to define entrepreneurship as the ability to deal with disequilibria rather than the ability to deal with uncertainty, risk does not enter prominently into his concept. By contrast, definitions of entrepreneurship that are uncertainty-based cannot logically relegate risk to a position of little or no importance.

D. Israel Kirzner

Another provocative "new" theory of entrepreneurship has been advanced by Israel Kirzner, a former student of Mises. Kirzner defines the essence of entrepreneurship as alertness to profit opportunities. Acknowledging the combined influence of Mises and Friedrich von Hayek, Kirzner offers his theory as a halfway house between the "neoclassical" view of Schultz and the "radical" view of Shackle. He attributes his basic approach to entrepreneurship to three important ideas: (1) Mises' central vision of the market as an entrepreneurial *process*; (2) Hayek's vital insight that the marketplace engenders a *learning* process; and (3) the conviction that entrepreneurial activities are creative acts of *discovery* (1985, p. 118).

Like Shackle, Kirzner is critical of mainstream economics because it leaves no room for purposeful human action. But unlike Shackle, Kirzner has no desire to jettison the equilibrium frame-

work of economics. For Kirzner, the role of the entrepreneur is to achieve the kind of adjustment necessary to move economic markets toward the equilibrium state. This crucial role is overlooked, he contends, by economic models that focus on equilibrium results rather than the *process* by which equilibrium is attained.

Following Mises, Kirzner maintains that mainstream neo-classical economics — as equilibrium analysis — defines "a state in which each decision correctly anticipates all other decisions" (1979, p. 110); one in which decisions are made and actions taken by mere mechanical calculations; in which judgement has no place; each market participant makes decisions that merely adjust given means to suit a given end. By contrast, in the dynamic economy, knowledge is neither complete nor perfect, therefore markets are constantly in states of disequilibrium, and it is disequilibrium that gives scope to the entrepreneurial function.

In his earliest formulation of entrepreneurship, Kirzner drew fire from several critics by advancing the concept of a "pure and penniless entrepreneur," that is, an entrepreneur who owns no capital. Kirzner's critics quickly pointed out that if one has nothing to lose, there is no sense in which that person can be said to bear risk, which is the essence of Mises' concept of entrepreneurship.²

In his lectures Kirzner likes to stress the analogy that the entrepreneur is a person who, upon seeing a \$10 bill on the ground in front of him, is alert to the opportunity and quickly grabs it. The alert person will seize it rapidly; the less alert will take longer to recognize the opportunity and to act on it. Not all entrepreneurs are created equal. By stressing pure alertness in this fashion, Kirzner emphasizes the quality of perception, recognizing an opportunity that is a sure thing; whereas in reality every profit opportunity is uncertain. Kirzner's best known case for illustrating alertness is that of the arbitrageur, the person who discovers the opportunity to buy at low prices and sell the same items at high prices, because of differences in intertemporal or interspatial demands. In these cases, Kirzner's entrepreneur requires neither capital, as does Mises's entrepreneur, nor imagination, as does Shackle's enterpriser.

Lawrence White (1976) and Murray Rothbard (1985) — the latter in his endorsement of a

discussion by Robert Hébert (1985) — questioned the role of uncertainty in Kirzner's view of the entrepreneur. The issue raised by these writers is that arbitrage deals with present, known opportunities to exploit price differences that exceed transaction/transfer costs over time or space, whereas uncertainty exists solely with respect to the future. By confining entrepreneurial activity to the practice of arbitrage, therefore, Kirzner downplays the importance of uncertainty in human decision making. The consequences are important to economic analysis because a theory that ignores uncertainty cannot explain entrepreneurial losses, only entrepreneurial gains.

In response to his critics, Kirzner has confronted this asymmetry and has altered his position somewhat. He now contends that uncertainty is central to the notion of entrepreneurial activity but he maintains that the relationship is more subtle than formerly supposed. Entrepreneurship that is also arbitrageurship involves discovery of past error (i.e., a single-period market decision), whereas entrepreneurship in the face of uncertainty involves multiperiod market decisions requiring the imagination and creativity of the Shacklean enterpriser. Both views define profit opportunities, but the latter gives wider scope to the framework-constructing talents of the entrepreneur and therefore emphasizes his history-making role. The former view, by contrast, emphasizes calculation and judgement by the entrepreneur within a *given* framework.

In a phrase, Kirzner now defends a synthetic view of entrepreneurship that combines the epoch-making activities of the entrepreneur (*à la* Shackle) with the corrective adjustments of the arbitrageur, which he formerly stressed. In this new form, the nature of entrepreneurship is more directly traced backwards through Mises to the original formulation of Cantillon. Time and uncertainty may alter the form of action called entrepreneurship but they do not change its essential function. This realization is the basis for Kirzner's "wider view":

In the single-period case alertness can at best discover hitherto overlooked current facts. In the multiperiod case entrepreneurial alertness must include the entrepreneur's perception of the way in which creative and imaginative action may vitally shape the kind of transactions that will

be entered into in future market periods (1985, pp. 63–64).

In other words, one must specify the nature of the market process under investigation in order to understand the concrete manifestation of the entrepreneurial function within that process.

III. Towards a synthesis

Space constraints have necessarily limited the above sketch of economists' views of entrepreneurship to mainline arguments. Nevertheless, the overview presented above is wide enough to demonstrate the diversity of opinion residing in economic literature. Analytic progress requires the formulation of uniform principles that achieve universal acceptance. It follows that analytic progress regarding the nature and role of the entrepreneur in economic theory has been impeded by lack of a uniform, universally accepted view of who the entrepreneur is and what he does. In an attempt to break down existing barriers, we propose the following 'synthetic' definition. The entrepreneur is *someone who specializes in taking responsibility for and making judgemental decisions that affect the location, form, and the use of goods, resources, or institutions*.³

This definition is 'synthetic' because it incorporates the main historical themes of entrepreneurship: risk, uncertainty, innovation, perception, and change. It accommodates a range of entrepreneurial activities within a market system, including but not limited to: coordination, arbitrage, ownership, speculation, innovation and resource allocation. It does not deny that entrepreneurship is typically mixed with other forms of economic activity, but it holds nevertheless that the essence of entrepreneurship can be conceptually isolated and separately analyzed.

The entrepreneur is a person, not a team, committee or organization. This person has a comparative advantage in decision making, and makes decisions that run counter to the conventional wisdom either because he has better information or a different perception of events or opportunities. An entrepreneur must have the courage of his convictions and face the consequences of his actions, whether they produce profits or losses. Entrepreneurial actions are

performed in all societies by individuals whose judgement differs from the norm. Military and political life provide as much scope for entrepreneurship as economic life, but capitalism is a peculiar set of institutions and property relations that provides the widest berth for entrepreneurship.

Any workable definition of entrepreneurship must be informed by the lessons of history. One lesson to be learned from the history of economics is that the problem of the place of entrepreneurship in economic theory is not a problem of theory *per se*, it is a problem of method. The history of economics clearly demonstrates that the entrepreneur was gradually extruded from economic analysis when economists attempted more and more to emulate the physical sciences by incorporating the mathematical method. Mathematics introduced greater precision to economics, and thereby promised to increase the power of economics to *predict*. Yet it was a two-edged sword. Its sharp edge cut through the tangled confusion of real-world complexity, making economics more tractable and accelerating its theoretic advance. But its blunt edge hacked away one of the fundamental forces of economic life — the entrepreneur. Because there was not and is not a satisfactory mathematics to deal with the dynamics of economic life, economic analysis evolved by concentrating on comparative statics, and the entrepreneur took on a purely passive, even useless, role.

A second lesson that emerges from the historical record is that in its most fruitful phase, theorizing about entrepreneurship has been part of the search for the basic tenets of the dynamics of economic life. The dynamics of economic life involve relations between people as well as the relations of people to material things. As economics became more like a branch of mechanics, it struck a kind of Faustian bargain in which its 'soul' was sacrificed for a better glimpse of the future (i.e., prediction). Yet this future should have been suspect all along, because the static method totally represses change, and dynamics *is* change. Change, in turn, is the province of the entrepreneur.

The question of whether the entrepreneur provokes change or merely adjusts to it has sparked a lively debate in the history of the

subject. Yet at the most elemental level, the issue is not that important. Entrepreneurial action may mean creation of an opportunity as well as response to existing circumstances. The basic elements of entrepreneurship are perception, courage, and action. The failure of perception, nerve, or action renders the entrepreneur ineffective. We must look to these elements for the distinctive nature of the concept, not to the circumstances of action or reaction.

The fact that entrepreneurship has a place in the world of economic dynamics and not in the world of economic statics forces us ultimately to confront the most basic of questions: What is the function of economics? Is it to enable us to understand the foundations of economic life or to predict the course of events that have yet to happen? If it is the former, we must take economic life as it is, with its imperfections, its uncertainties, its risks. If it is the latter, we may confidently jettison certain real-life conditions from our models, but we would be foolish to ignore the costs of doing so. Ultimately the fate of entrepreneurship within the corpus of economic theory depends on the kind of choice economists make. We may sacrifice realism on the one hand to gain precision, or we may give up precision on the other hand to gain realism. The reason the entrepreneur is such an important object of economic concern is because its function and character penetrate to the very core of economics and raise fundamental questions of economic method that have never been resolved. Indeed, they have not even been fully discussed in the economic light of day. Therefore, if we are ever to learn who the entrepreneur is and what he/she does that is so vital to the operation of economic markets in a free society, we must resolve those stubborn methodological problems that currently block the way to meaningful analytical progress.

Notes

¹ We cannot hope to accomplish this task completely in the space provided here. A more detailed and lengthy attempt at the same goal is contained in our forthcoming book (Hébert and Link, 1988), on which this paper draws freely.

² Mises (1951, p. 13) wrote: "There is a simple rule of thumb to tell entrepreneurs from non-entrepreneurs. The entrepreneurs are those on whom the incidence of losses on the capital employed falls."

³ This definition is compatible with that offered recently by Mark Casson (1982), who approached the same subject from a theoretical rather than a historical perspective.

References

- Cantillon, Richard, 1931, *Essai sur la nature du commerce en général*, edited and translated by H. Higgs, London: Macmillan.
- Casson, Mark, 1982, *The Entrepreneur: An Economic Theory*, Totowa, N.J.: Barnes & Noble.
- Ehrlich, Elizabeth, 1986, 'America Expects too Much from Its Entrepreneurial Heros', *Business Week* (July 28): 33.
- Gumpert, David E., 1986, 'Stalking the Entrepreneur', *Harvard Business Review* 64, 32–36.
- Hayes, Robert H. and William J. Abernathy, 1980, 'Managing Our Way to Economic Decline', *Harvard Business Review* 58, 67–77.
- Hébert, Robert F., 1985, 'Was Richard Cantillon an Austrian Economist?', *Journal of Libertarian Studies* 7, 269–79.
- Hébert, Robert F. and Albert N. Link, 1988, *The Entrepreneur: Mainstream Views and Radical Critiques*, second edition, New York: Praeger.
- Hirschman, Albert O., 1958, *The Strategy of Economic Development*, New Haven, CT: Yale University Press.
- Hisrich, Robert D., 1986, 'Entrepreneurship and Intrapreneurship: Methods for Creating New Companies That Have an Impact on the Economic Renaissance of an Area', in R. D. Hisrich (ed.), *Entrepreneurship, Intrapreneurship and Venture Capital*, Lexington, MA: D.C. Heath.
- Kirzner, Israel M., 1973, *Competition & Entrepreneurship*, Chicago: University of Chicago Press.
- Kirzner, Israel M., 1979, *Perception, Opportunity, and Profit: Studies in the Theory of Entrepreneurship*, Chicago: University of Chicago Press.
- Kirzner, Israel M., 1985, *Discovery and the Capitalist Process*, Chicago: University of Chicago Press.
- Klein, Burton H., 1979, 'The Slowdown in Productivity Advances: A Dynamic Explanation', in C. T. Hill and J. M. Utterback (eds.), *Technological Innovation for a Dynamic Economy*, New York: Pergamon Press.
- Knight, F. H., 1921, *Risk, Uncertainty and Profit*, New York: Houghton Mifflin.
- Link, Albert N., 1987, *Technological Change and Productivity Growth*, London: Harwood Academic Publishers.
- Mettler, Ruben F., 1986, 'Innovation, Job Creation, and Competitiveness', in *The Positive Sum Strategy: Harnessing Technology for Economic Growth*, Washington, D.C.: National Academy Press.
- Mises, Ludwig, 1951, *Profit and Loss*, South-Holland, Illinois: Consumers-Producers Economic Service.
- Rothbard, Murray N., 1985, 'Professor Hébert on Entrepreneurship', *Journal of Libertarian Studies* 7, 281–286.
- Schultz, Theodore W., 1975, 'The Value of the Ability to Deal with Disequilibria', *Journal of Economic Literature* 13, 827–846.
- Schultz, Theodore W., 1980, 'Investment in Entrepreneurial Ability', *Scandinavian Journal of Economics* 82, 437–448.
- Schumpeter, Joseph A., 1928, 'The Instability of Capitalism', *Economic Journal* 38, 361–386.
- Schumpeter, Joseph A., 1934, *The Theory of Economic Development*, translated by R. Opie from the 2nd German edition [1926]. Cambridge: Harvard University Press.
- Schumpeter, Joseph A., 1950, *Capitalism, Socialism and Democracy*, 3rd ed. New York: Harper & Row.
- Schumpeter, Joseph A., 1954, *History of Economic Analysis*, edited by E. B. Schumpeter, New York: Oxford University Press.
- White, Lawrence H., 1976, 'Entrepreneurship, Imagination and the Question of Equilibration', manuscript.

Copyright of Small Business Economics is the property of Kluwer Academic Publishing / Business and its content may not be copied or emailed to multiple sites or posted to a listserv without the copyright holder's express written permission. However, users may print, download, or email articles for individual use.