Putting Entrepreneurship into Strategy and Organization Studies

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About me

► PhD, Economics, University of California, Berkeley
  ▪ Economics of institutions, industrial organization

► Research areas
  ▪ Transaction cost economics, corporate strategy, Austrian and evolutionary economics, entrepreneurship, food and agriculture

► Current research streams and projects
  ▪ Performance effects of diversification and organizational form
  ▪ Emergence of new organizations and organizational forms in biotechnology and food production
  ▪ Developing an entrepreneurial theory of the firm
  ▪ Organization of private equity and venture capital
Affiliations

► About CORI
  ▪ Inspired by Ronald Coase
  ▪ Full-text-searchable database of over 700,000 contract documents
    (including business recombinations, business transactions,
    compensation/employment, finance, franchise agreements, governance,
    litigation, reorganization/bankruptcy, securities) [demo]
  ▪ Research in economics and law of contracts and organizational structure

How I got here

[Images of people and books]
Today’s talk

► Background on entrepreneurship research phenomenon
► Summarize ongoing research project on the relationship between entrepreneurship and the economic theory of the firm
  ▪ Particularly transaction cost economics, the property-rights approach, and agency theory, but also the RBV
  ▪ Mostly focused on conceptual clarification and theory development!
► Who cares?
  ▪ Weak links between existing entrepreneurship literature and the economic theory of the firm
  ▪ But clear potential connections: firms are founded by entrepreneurs and entrepreneurship is usually exercised inside a firm!
  ▪ “[A] critical question concerns how the exploitation of entrepreneurial opportunities is organized in the economy” (Shane and Venkataraman, AMR, 2000).

Specific questions

► Can entrepreneurial ideas, discoveries, “judgments,” etc., be traded in markets? Do entrepreneurs need firms to realize their plans? Why?
► Do entrepreneurs need to own factors of production?
► How can firms stimulate “intrapreneurship”? What are its benefits and costs, at the margin? What is the optimal amount and form of intrapreneurship?
► How do the competitive, technological, and regulatory environments affect the exercise of entrepreneurship?
The entrepreneurship research phenomenon

► Explosion of entrepreneurship courses and faculty positions at US universities and colleges (Kuratko, 2003)
  ▪ 2,200 entrepreneurship courses at 1,600 schools
  ▪ 277 endowed faculty positions and 100 funded centers
  ▪ During 1990s, 250% increase in listed academic positions, 100% increase in candidates (Finkle and Deeds, 2001)

► New infrastructure
  ▪ Several specialty journals (JBV, SBE, ETP, SEJ) and more space in mainstream economics and management journals
  ▪ Thriving Entrepreneurship Division at AoM
  ▪ Possible JEL category for entrepreneurship
  ▪ Infusion of funds from Kauffman, others

► Boom and bust?

Entrepreneurship and public policy

► World Bank, IFC, other development agencies: new emphasis on entrepreneurship as well as institutions
  ▪ Rapid Response Group
  ▪ Finance and Private Development Group
  ▪ Private Sector Development Blog

► Microfinance institutions
  ▪ Grameen Bank: a Nobel for entrepreneurship?
  ▪ The current crisis and small-business finance?

► But: bailouts and stimulus package
  ▪ Whither Schumpeterian competition?
Why is entrepreneurship such a hot topic?

► Belief that startups, venture funding, intellectual property, innovation, technology, etc. are increasingly important in the economy
► Emphasis on economic development as a fourth mission of the (US) public research university
► Dissatisfaction with mainstream neoclassical economics and established models in strategy and organization
► Bandwagon effect?

Is entrepreneurship a new concept?

► Prominent place in the history of economic thought
  ▪ Richard Cantillon (1755)
  ▪ J. B. Say (1803)
  ▪ Carl Menger (1871)
  ▪ Joseph Schumpeter (1911)
  ▪ Frank Knight (1921)
► Little role for entrepreneurship in mainstream economic theory since WWII
  ▪ Emphasis on formal equilibrium modeling
  ▪ Centrality of perfectly competitive model
What exactly do we mean by “entrepreneurship”? 

► Occupational concepts
  ▪ Entrepreneur = self-employed individual
  ▪ Labor economics literature on occupational choice
  ▪ Psychological and sociological studies of the founder’s characteristics

► Structural concepts
  ▪ Unit of analysis: the firm or industry
  ▪ Entrepreneurial firm = new or small firm
  ▪ IO literature on industry evolution (Acs, Audretsch, etc.)

► Functional concepts
  ▪ Judgment (Cantillon, Knight, Mises, Casson, Foss and Klein)
  ▪ Innovation (Schumpeter, Baumol), alertness (Kirzner)
  ▪ Tendency to black-box the function itself
  ▪ Little relationship to occupational and structural approaches!

Entrepreneurship and the firm


Entrepreneurship and the firm: questions

► Organizing entrepreneurship
  ▪ Does the entrepreneur need a firm?
  ▪ How do firm organization and market structure affect entrepreneurship?

► Putting entrepreneurship into the theory of the firm
  ▪ Where can entrepreneurship fit into contemporary theories of the firm?

► Objectives: broadening the scope of entrepreneurship research
  ▪ Not just startups!
  ▪ More than individuals and their characteristics
  ▪ Includes mundane activities

Does the entrepreneur need a firm?

► Entrepreneurship as innovation
  ▪ Innovator can sell or license

► Entrepreneurship as opportunity discovery
  ▪ Doesn’t require asset ownership
  ▪ Can be bought and sold on the market
  ▪ The (mis-)use of Kirzner’s discovery metaphor
Entrepreneurial judgment and the firm

► Knightian judgment
  ▪ Entrepreneurship as judgmental decision-making under uncertainty
  ▪ Investment, not opportunity identification or creation, as the entrepreneurial act

► Austrian capital theory
  ▪ Heterogeneity
    ▪ Many ad hoc concepts in economics and strategy (asset specificity, core competences, unique capabilities)
    ▪ Austrian contribution: time structure of production
    ▪ Attributes approach: uses, services, applications, etc. of assets, not all of which are known or created ex ante — experimentation is required
  ▪ Subjectivism
    ▪ Profit opportunities are neither “discovered” nor “created,” but imagined

Entrepreneurial judgment and the firm (cont.)

► Implications for the “classic Coasian questions”
  ▪ Existence
    ▪ Non-contractibility of entrepreneurial judgment
      Knight (1921): “The only ‘risk’ which leads to a profit is a unique uncertainty resulting from an exercise of ultimate responsibility which in its very nature cannot be insured nor capitalized nor salaried. Profit arises out of the inherent, absolute unpredictability of things.”
    ▪ Firms as controlled experiments
  ▪ Boundaries: entrepreneurial experimentation with combinations of heterogeneous resources
  ▪ Internal organization: original and derived judgment
    ▪ Employees as “proxy entrepreneurs”
    ▪ Productive and destructive proxy-entrepreneurship
    ▪ Optimal delegation as the choice of efficient tradeoffs
Entrepreneurship and capital heterogeneity

► A good summary statement
We are living in a world of unexpected change; hence capital combinations . . . will be ever changing, will be dissolved and reformed. In this activity, we find the real function of the entrepreneur. As long as we disregard the heterogeneity of capital, the true function of the entrepreneur must also remain hidden. (Lachmann, 1956)

► Implications
- The unit of analysis
- Opportunities and organizational form
- Entrepreneurial teams

The unit of analysis

► If opportunities are (a) subjective and (b) a black box, then the unit of analysis shouldn’t be the opportunity or problem, but some action.
  - Analogy with preferences, again (treat as latent and use SEM?)
  - Casson’s notion of projects (Casson and Wadeson, 2007) – a stock of resources committed to particular activities (opportunities are potential, but inactive, projects)

► Emphasizes on opportunity exploitation, not identification
  - More generally, the execution of business plans
  - Specifically: assembly of heterogeneous resources under uncertainty
    - Obvious connections with RBV (especially the Penrosian version – see Foss, Klein, Kor, and Mahoney, 2008)
    - Entrepreneur as agent who exploits resource substitutability and complementarity in the face of transaction costs
Application I: opportunities and organizational form

► Attempts to encourage opportunity discovery do not necessarily foster opportunity exploitation.
  ▪ Efficiency requires that entrepreneurs (and what Foss, Foss, and Klein 2007 call “proxy-entrepreneurs”) bear the full wealth effects of their actions.
  ▪ Inside the firm: promoting experimentation, creativity, etc. encourages moral hazard unless rewards and punishments are symmetric.
  ▪ Outside the firm: strong IP regime, SBIR programs, bailouts, etc. may encourage overspending on discovery.

► Organizing for opportunity exploitation
  ▪ Staged finance
  ▪ Policy regime that allows entrepreneur–financiers to experiment with combinations of businesses (and to make losses!)

Application II: entrepreneurial teams

► Perception of a (subjectively identified) opportunity is an individual act, but exploitation of opportunities can be a team or group activity.
  ▪ Syndicated venture capital, private equity, loans
  ▪ Partnerships (professional services firms, closed-membership coops)
  ▪ Entrepreneurial networks (Parker, JBV, forthcoming)

► Sharing perceived opportunities
  ▪ Penrose and the management team as a bundle of heterogeneous human resources, shaped by experiential learning (Foss, Klein, Kor, and Mahoney, 2007)
  ▪ Cooperatives, partnerships, corporations: convincing others to invest

► Organizational costs of collective action (Olson, Hansmann)
Application II: entrepreneurial teams (cont.)

- Evidence from “new generation” cooperatives in Renville, Minn. (Chambers, Cook, and Klein, 2005; Chambers, 2007)
  - Creation and diffusion of a new organizational form
  - Role of the project champion(s)
  - Social networks, shared experience, and the willingness to invest
  - Path dependence and the stickiness of shared mental models (difficulty of conversion to LLC)

Closing thoughts

- Putting entrepreneurship into strategy and organization: what difference would it make?
  - Occupational and structural approaches: probably not much (just a relabeling)
  - Functional approaches: a Coasian-style revolution?

- Concept of entrepreneurial judgment has important implications for firm organization and strategy
  - Central problems: organizing, trading, managing judgment
  - Weak spots: empirical applications, testable (and discriminating) hypotheses, links to other topics in management (e.g., learning)

- Hopefully much more to come!