

# Putting Entrepreneurship into Strategy and Organization Studies

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## About me

- ▶ **PhD, Economics, University of California, Berkeley**
  - Economics of institutions, industrial organization
  - Dissertation: “Conglomerate Organization and Economic Performance: Evidence from the 1960s” (Williamson, Teece, Hall)
- ▶ **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

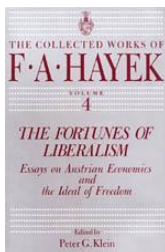
## Affiliations



### ► 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



## 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?

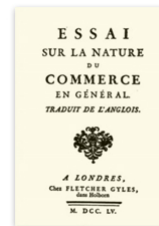
## Why is entrepreneurship such a hot topic?

- ▶ 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)
  - Ludwig von Mises (1949), Israel Kirzner (1973), T. W. Schultz (1978, 1981)
- ▶ Little role for entrepreneurship in mainstream economic theory since WWII
  - Emphasis on formal equilibrium modeling
  - Centrality of perfectly competitive model

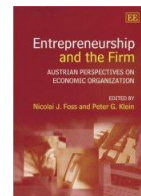


## What exactly do we mean by “entrepreneurship”?

- ▶ **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

- ▶ Foss and Klein, eds., *Entrepreneurship and the Firm: Austrian Perspectives on Economic Organization* (Elgar, 2002).
- ▶ Foss and Klein “Entrepreneurship and the Economic Theory of the Firm: Any Gains from Trade?” (*Handbook of Entrepreneurship Research*, 2005).
- ▶ Foss, Foss, Klein, and Klein, “The Entrepreneurial Organization of Heterogeneous Capital” (*JMS*, 2007).
- ▶ Foss, Foss, and Klein, “Original and Derived Judgment: An Entrepreneurial Theory of Economic Organization” (*Org. Stud.*, 2007).
- ▶ Foss, Klein, Kor, and Mahoney, “Entrepreneurship, Subjectivism, and the Resource-Based View: Towards a New Synthesis” (*SEJ*, 2008).



- ▶ Klein, “Opportunity Discovery, Entrepreneurial Action, and Economic Organization” (*SEJ*, 2008).
- ▶ Foss and Klein, *Entrepreneurial Judgment and the Theory of the Firm* (Cambridge University Press, manuscript in preparation).



## 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!