Exploratory Note 1

The Entrepreneurial Environment: Capitalism, Entrepreneurship,

and (Some) Economic Theory

**INTRODUCTION**

Though this course largely focuses on applied materials, this first exploratory note of the semester is decidedly theoretical in content—as are the next several as well. Though entrepreneurship as an academic discipline continues to lack generally accepted cumulative or unified theory of its own and has historically focused more on describing (as opposed to predicting) entrepreneurial phenomena, the entrepreneurship literature does draw sustenance from the theoretical wells of other better established disciplines. In this note, my primary concern is the relationship between entrepreneurship and capitalist economics.

To put things into proper perspective, it is logical to consider a number of questions: What is the role of the entrepreneur in a capitalist economy? Within what context does the entrepreneur play such a role? What motivates the entrepreneur to take action? Towards what ends does the entrepreneur strive? What forces act to assist the entrepreneur in realizing success? What forces act to inhibit the entrepreneur from realizing success?

These questions are not easy to answer as each one has and continues to elicit vigorous debate within academic circles. Economics alone offers numerous answers depending on perspective. In this note, we consider a couple of entrepreneur-centric approaches in stark juxtaposition to the mainstream of economic thought.

**THE ENTREPRENEUR – ROLES, CONTEXT, MOTIVATIONS, ETC.**

Before moving on to address the relevant theory, let us consider individually the questions outlined in the introduction.

What is the role of the entrepreneur in a capitalist economy?

Within what context does the entrepreneur play such a role?

What motivates the entrepreneur to take action?

Towards what ends does the entrepreneur strive?

What forces act to assist the entrepreneur in realizing success?

What forces act to inhibit the entrepreneur from realizing success?

**THE NEOCLASSICAL SYNTHESIS, THE ENTREPRENEUR, AND PROFIT**

In our discussion so far, profit has had a notable place. This should come as no surprise, right? After all, in a capitalist system, it is profit that is supposed to motivate us. Consider Adam Smith in *The Wealth of Nations* (1776):

“The consideration of his own private profit is the sole motive which determines the owner of any capital to employ it either in agriculture, in manufactures, or in some particular branch of the wholesale or retail trade.”

Though most of us take for granted the idea that the pursuit of profits is the primary motivator of capitalist economics, profit is actually a poorly developed concept—oftentimes spoken of, but perhaps rarely understood. Theoretically, explanations are all over the board.

Interestingly enough, in the mainstream synthesis of neoclassical and Keynesian economics (which no doubt colored your introductory economics courses), the concept of profit has no place in the long-run. Why?

So, the assumption of perfect competition drives equilibrium and, therefore, eliminates profits. Where does that leave the entrepreneur? In a state of irrelevance.

**SCHUMPETER AND THE DISRUPTIVE ENTREPRENEUR**

In the world of general equilibrium (which empirically does not seem to be all that similar to our own), scant attention need be paid to the entrepreneur. Though such theoretical parsimony certainly has a great deal of value, alternative frameworks exist which not only include the entrepreneur, but identify the entrepreneur’s profit-seeking role as being critical to the dynamic change inherent to capitalist systems. One such framework was established many years ago by Joseph Schumpeter—one of the most influential economists of the first half of the twentieth century.

In his outstanding work, *Capitalism, Socialism and Democracy* (1947), Schumpeter argues that

“the essential point to grasp is that in dealing with capitalism we are dealing with an evolutionary process…by nature a form or method of economic change and not only never is but never can be stationary. And this evolutionary character of the capitalist process is not merely due to the fact that economic life goes on in a social and natural environment which changes and by its change alters the data of economic action; this fact is important and these changes (wars, revolutions and so on) often condition industrial change, but they are not its prime movers. Nor is this evolutionary character due to a quasi-automatic increase in population and capital or to the vagaries of monetary systems of which exactly the same thing holds true. *The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers’ goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates*” [emphasis my own].

And who drives these changes? Entrepreneurs! For Schumpeter, the change wrought by entrepreneurs

“incessantly revolutionizes the economic structure *from within* [emphasis in original], incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in.”

What are the some of the implications of such insights for the entrepreneur—especially when it comes to the environment within which entrepreneurs operate and the forces which may either drive or hinder success?

**KIRZNER AND THE EQUILIBRIATING ENTREPRENEUR**

For Schumpeter, the entrepreneur is a disruptive actor in the economic system—upsetting equilibrium with his or her innovation. But, not all entrepreneur-aware theorists see it this way. Consider Israel Kirzner, part of the Austrian School, who argues that “the entrepreneur profits from his alertness to opportunities that exist in an uncertain, nonequilibrium situation…[enabling] the entrepreneur to perceive those opportunities before others do” (Cheah 1990). In other words, the entrepreneur is perceived not as a force for destabilization, but as a force for stabilization.

What are some of the implications of Kirzner’s insights?

**DEFINITIONS AND IMPLICATIONS**

Now, it would not surprise me if many of you dream of becoming a true Schumpeterian entrepreneur. After all, is it not the innovators who seem to get all of the attention? Is it not innovation upon which an entire investment approach (venture capital) has been established? The answer is yes to both questions; however, it should not be forgotten that a multitude of great companies have been developed and great fortunes have been made doing things that were not all that revolutionary.

Consider a couple different sets of people. First, a (rather specific) group that would probably make the Schumpeterian cut:

John D. Rockefeller

Henry Ford

John Bogle

Elon Musk

Jeff Bezos

Second, a (more generic) group that probably would not:

The founder of an RIA firm

The founder of a commercial bank

The founder of an investment bank

The founder of a trucking company

The founder of a restaurant

For Kirzner, no such distinction between innovators and imitators exists—thereby making room for the overwhelming majority of business owners who employ other people but pursue a host of blander opportunities. There is nothing wrong with wanting to shake up the *status quo* in a big way, but try not to lose sight of the full array of opportunities, some perhaps less exciting than others, which can still be very worthwhile.[[1]](#footnote-1)

**THE ENTREPRENEURIAL ENVIRONMENT – ONE OF INHERENT CONFLICT**

Taken together, Schumpeter and Kirzner yield a dual track for entrepreneurs—one which destabilizes and another which stabilizes the system. In either case, entrepreneurs are bound to find themselves in conflict with others. For innovators, those who drive the revolutionary processes of Creative Destruction, much opposition should be expected from those who benefit from the *status quo*. Remember, innovation puts others out of business and out of work. Vigorous push back is only natural. For imitators, the same rules apply. If a local market has an imperfection that is exploitable, imitators might be well served by rushing to exploit it; however, it is highly unlikely that the existing parties will go down without a fight. And, notwithstanding *homo economicus*, rationality does not always reign supreme. Does this match your expectations?

Something to keep in mind: though entrepreneurial endeavors are often highly romanticized, the experience is typically, to borrow a bit out-of-context from Thomas Hobbes, “solitary, poor, nasty, brutish, and short.” And the empirical evidence agrees. Of course, I write this not to discourage, but make you aware.

1. Due to time constraints and the nature of mainstream economic and financial theory, I have adopted the realist assumption that entrepreneurial opportunities exist independent of entrepreneurs and must, therefore, be *discovered*. There is, however, a growing school of thought based on social constructivism which suggests that entrepreneurial opportunities are socially constructed, or created, by entrepreneurs. [↑](#footnote-ref-1)