

THE DISTINCTIVE DOMAIN OF ENTREPRENEURSHIP RESEARCH

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Interest in entrepreneurship has heightened in recent years, especially in business schools. Much of this interest is driven by student demand for courses in entrepreneurship, either because of genuine interest in the subject, or because students see entrepreneurship education as a useful hedge given uncertain corporate careers. This demand for entrepreneurship education has attracted attention to the intellectual content of the field, especially at the more research-oriented universities. And with this attention comes a challenge. The researchers and educators in the field must confront the question "what is the distinctive contribution of our field to a broader understanding of business enterprise?" To the extent that our answer to this question is unclear, delayed and overlaps with other sub-fields, our legitimacy and our very survival in the world of business research and education is seriously threatened.

A general reading of the entrepreneurship journals shows a pre-occupation with the success or failure of individual entrepreneurs and firms.

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While the issue of performance is certainly important, what qualifies these studies as entrepreneurship seems to be the context of the investigation, namely, small business or corporate venture initiatives. As I noted elsewhere (Venkataraman, 1994), much water has flowed under the relative performance bridge in other fields. By pursuing the relative performance theme *ad nauseam*, we neither stake out a unique territory for entrepreneurship research nor clearly distinguish ourselves from our sister fields in the business school.

The issue of our distinctive contribution naturally raises the question of what exactly is the subject matter of entrepreneurship. To many the field of entrepreneurship is a mystery. Although most people would agree that it is an important area of inquiry, many are not sure about its claims for intellectual legitimacy. The distinctive domain of the field is far from clear.

The main problem is the lack of a well-accepted definition of the boundaries of the field. Although numerous definitions have been offered, none have prevailed. Scholars have traditionally tried to define the field in terms of the entrepreneur or what the entrepreneur does but because there are fundamentally different interpretations of these two concepts, consensus on a definition of the field is perhaps not possible. (See Gartner, 1988 for some compelling statements on this topic.)

This chapter takes a different tack in defining the field of entrepreneurship. Economists do not define economics by defining the resource allocator, nor do sociologists define their subject matter by defining society. Likewise, it would be a mistake for us to define our field by defining the entrepreneur. It would be more useful to define the field in terms of the central issues that concern us as an invisible college. Our field is fundamentally concerned with understanding how, in the absence of current markets for future goods and services, these goods and services manage to come into existence.¹ Thus, entrepreneurship as a scholarly field *seeks to understand how opportunities to bring into existence "future" goods and services are discovered, created, and exploited, by whom, and with what consequences.* As researchers we approach the subject using different perspectives, theories and methods. But it cannot be denied that what unites us as a distinctive, although invisible, college is a concern with the central issues in the definition above.

At its core the field is concerned with (1) why, when and how opportunities for the creation of goods and services in the future arise in an

economy; (2) why, when, and how some are able to discover and exploit these opportunities while others cannot or do not; and, finally, (3) what are the economic, psychological, and social consequences of this pursuit of a future market not only for the pursuer, but also for the other stakeholders and for society as a whole. I submit that the connection between the pursuit of a product-market in the future and the creation of social wealth offers both a distinctive voice and a worldview and thus constitutes a legitimate domain for our field. Within these boundaries there are several interesting questions that have been largely neglected by scholars in the field.

CENTRAL PREMISES

Although our invisible college does not share a consensus definition, most scholars of entrepreneurship would acknowledge two fundamental premises. The first, which I call the weak premise of entrepreneurship, holds that in most societies, most markets are inefficient most of the time, thus providing opportunities for enterprising individuals to enhance wealth by exploiting these inefficiencies. The second, which I call the strong premise of entrepreneurship, holds that even if some markets *approach* a state of equilibrium, the human condition of enterprise, combined with the lure of profits and advancing knowledge and technology, will destroy the equilibrium sooner or later.

The weak premise, although present implicitly in most works on entrepreneurship, reached its clearest articulation in the works of Kirzner (e.g., Kirzner, 1979; 1985), while the strong premise is probably most familiar to people as Schumpeter's "process of creative destruction" (Schumpeter, 1976). These two premises are based on the underlying assumption that change is a fact of life. And the result of this natural process is both a continuous supply of lucrative opportunities to enhance personal wealth, and a continuous supply of enterprising individuals seeking such opportunities. Two issues are of particular interest to scholars in entrepreneurship: the sources of opportunities and the nexus of opportunity and enterprising individuals.

OPPORTUNITIES AND INDIVIDUALS

In an important paper called "The Use of Knowledge in Society" Hayek (1945) pointed out that the central feature of a market economy is the

partitioning of knowledge among individuals, such that no two individuals share the same knowledge or information about the economy. Hayek specifically referred to day-to-day knowledge (and not necessarily to scientific knowledge), such as that associated with particular occupations; resources that are lying fallow; a better way of doing a particular job; a key resource that is becoming scarce; the discovery of a breakthrough in the laboratory that leads to a new technique, method of production, or technology; the existence of a critical need in a particular segment of society, and so forth. The key is that this knowledge is diffused in the economy and is not a "given" or at everyone's disposal. Thus, only a few people know about a particular scarcity, or a new invention, or a particular resource lying fallow, or is not being put to best use. This knowledge is typically idiosyncratic because it is acquired through each individual's own circumstances including occupation, on-the-job routines, social relationships, and daily life. It is this particular knowledge, obtained in a particular "knowledge corridor," that leads to some profit making "insight" (Kirzner, 1985; Nelson & Winter, 1982). The dispersion of information among different economic agents who do not have access to the same observations, interpretations or experiences (Arrow, 1974) has two fundamental implications for entrepreneurship research: first, opportunities for discovering or creating goods and services in the future exist precisely because of the dispersion of information. It is this dispersion that created the opportunity in the first place. Second, the very same dispersion presents hurdles for exploiting the opportunity profitably, because of the absence or failure of current markets for future goods and services. It is therefore necessary to understand first how opportunities for the creation of new goods and services arise in a market economy; and second, it is necessary to understand how and in what ways individual differences determine whether hurdles in the process of discovering, creating and exploiting opportunities are overcome.

One of the most neglected questions in the entrepreneurship literature is where opportunities to create goods and services in the future come from. Although this question should form the core of the field, none of the journals contain articles that mention this issue. Drucker (1985) has identified three classes of opportunities. The first is inefficiencies within existing markets due either to information asymmetries among market participants, or to the limitations in technology to satisfy certain known but unfulfilled market needs. The second is the emergence of significant

changes in social, political, demographic, and economic forces that are largely outside the control of individual agents. The third source is inventions and discoveries that produce new knowledge. Research on the taxonomy and sources of opportunities, their characteristics, the relative incidence of different opportunities in different contexts and countries, and the relative profitability of different sources of opportunities are all virgin territories for the field of entrepreneurship.

It is one thing for opportunities to exist, but an entirely different matter for them to be discovered and exploited. Opportunities rarely present themselves in neat packages. They almost always have to be discovered and packaged. Thus, the nexus of opportunity and enterprising individual is critical to understanding entrepreneurship. At the core of the two premises outlined above is the belief *that people are different and these differences matter*. These differences give rise to many of the interesting questions in entrepreneurship. Indeed, by emphasizing and illuminating individual differences entrepreneurship can emerge as a legitimate field with its own distinctive domain within the broader field of business research and education.

A related question is what separates those who exercise individual enterprise from those who don't. Or, in more operational terms, what triggers the search for and exploitation of opportunities in some, but not in others? By triggers, I am referring not to the psychological or sociological traits that may propel people to certain actions that can be called entrepreneurial. Although the "traits" approach (Aldrich, 1991) is definitely within our domain, the findings of this research over the past 30 years have been at best inconclusive (see Shaver & Scott, 1991, for a good review). I would like to draw attention to three other areas that have been largely ignored by entrepreneurship researchers, namely knowledge (and information) differences, cognitive differences, and behavioral differences.

The role of *specific knowledge* and "knowledge corridors" in motivating the search for profitable opportunities has received little attention since Hayek's (1945) observation about the dispersion of information in society. This topic is critical to our understanding of what triggers the search for and exploitation of opportunities by some individuals but not others. *The possession of useful knowledge varies among individuals and these differences matter. This variable strongly influences the search for and the decision to exploit an opportunity, and it also influences the relative success of the exploitation process.*

Specific knowledge by itself may only be a sufficient condition for the exercise of successful enterprise. The ability to make the connection between specific knowledge and a commercial opportunity requires a set of skills, aptitudes, insight, and circumstances that is not either uniformly or widely distributed. Thus, two people with the same knowledge may put it to very different uses. It is one thing to have an insight, but an entirely different matter to profit from it. The incentive, capability, and specific behaviors needed to profit from useful knowledge or insight all vary among individuals, and these differences matter for explaining the exercise of enterprise.

A few scholars have begun to investigate the process by which knowledge is converted to commercial venture. Their combined work suggests that three factors play an important role in this process. The first is cognitive conditions (see Shaver & Scott, 1991, for a comprehensive review). The second is the incentive to incorporate (see, e.g., Amit et al., 1994, Reynolds et al., 1991, who emphasize low opportunity cost or lack of alternatives as strong incentives; as contrasted with Schumpeter, 1976, and Kirzner, 1973, who both emphasize the potential size of the profits to be made as a powerful incentive). The third is differences in creative processing (e.g., Schumpeter's *creativity* [1976]; Kirzner's *alertness* [1973]; or Shackle's *imagination* [1982]). While these variables are usually treated as working independently, I suspect that they will have greater explanatory power if they are treated as interacting variables. *Cognitive conditions, incentives, and creative processing vary among individuals and these differences matter. These variables strongly influence the search for and exploitation of an opportunity, and they also influence the success of the exploitation process.*

THE NON-EXISTENCE OF MARKETS AND THE EXISTENCE OF ENTREPRENEURSHIP

Bringing new products and markets into existence almost always involves an element of downside risk. By definition entrepreneurship requires making investments (time, effort, and money) today without knowing what the distribution of the returns will be tomorrow. There is a fundamental uncertainty that cannot be insured against or diversified away (Knight, 1921). Indeed, it is the uncertainty that provides the opportunity for profit in the first place (Knight, 1921; Rumelt, 1987).

Individuals vary in their perception of such downside risks, and in their aptitudes and capacities to deal with and manage them. The cognitive processing of risks has been relatively neglected by the field of entrepreneurship in spite of the rich research that is available from cognitive psychology (see a recent work by Busenitz & Barney, 1997, for one example). From this research we know that people have systematic biases and heuristics for dealing with uncertainty (see Kahneman & Lovallo, 1994; Conlisk, 1996 for some reviews). Briefly we know that (1) self assessed chances of success are uncorrelated with statistical generalities; (2) when immediate past performance or opportunity cost is low, there is a propensity to take greater chances, and when immediate past performance is strong or opportunity cost is high, there is a tendency to avoid risk; (3) uncomfortable statistical truths are ignored; (4) most people are loss averse, that is they try to avoid losses even when the upside more than compensates for possible losses; (5) loss aversion does not depend on the size of the stake; (6) people consider projects or investments one at a time and do not consider risk pooling or a project within a portfolio of several projects, each with different probabilities of success; and (7) people often treat problems as unique and not as statistical patterns or regularities. *The significant issue is that individuals vary in how they process and interpret statistical generalities and these variations may have significant but systematic impact on the decision to become an entrepreneur and the relative success of the endeavor.*

While idiosyncratic insight and the relatively rare ability to convert knowledge to commercial profit leads to successful enterprise, these same qualities also present entrepreneurs with problems. In a typical scenario, entrepreneur does not own or control all the resources required to develop the market, establish the value-chain infrastructure, and eventually profit from his or her particular knowledge. Most of these resources have to come from other people and institutions. Thus, the entrepreneur has to assemble, organize and execute the market development and value-chain infrastructure before potential profits can be realized and conjectures proven to be "insights." The process of creating products and markets implies that much of the information required by potential stakeholders—for example technology, price, quantity, tastes, supplier networks, distributor networks, and strategy—is not reliably available. Relevant information will only exist once the market has been successfully created (Arrow, 1974). Potential stakeholders thus have to rely on the entrepreneur for information, but without the benefit of the

entrepreneur's special "insight." In almost every project entrepreneurs have more information about the true qualities of the project and themselves than any of the other parties. Because of this information asymmetry, neither buyers nor suppliers may be willing to make the necessary investments in specialized assets or formal cooperative arrangements to develop the business. As a result the market process may fail.²

Even if suppliers and other resource controllers were willing to overlook the uncertainty, or were willing to make specialized investments with a due risk premium, there remains the ever present danger of "opportunism" (Williamson, 1975), which means the entrepreneur (or supplier) fails to comply with contracts and agreements. Once specialized investments have been committed, the entrepreneur (or the supplier) can hold the other party "hostage" in order to drive more favorable bargains. Of course, it is not possible once an investment has been made, to ensure that the entrepreneur's every action (or inaction—the problem of shirking) is in the best interests of the resource suppliers or vice-versa.³ In this situation establishing cooperative relationships is difficult unless the entrepreneur is willing to make significant, irreversible, and credible commitments to the business. This drives up sunk costs and therefore presents downside risk for the entrepreneur.

In spite of the absence of current markets for future goods and services, and in spite of the moral hazard problem when dealing with investors, suppliers and customer markets for those future goods and services, the simple fact is that some individuals do indeed create new markets and products. *The significant point is that despite the existence of adverse selection and moral hazard problems, some individuals are able to successfully overcome these hurdles and achieve success. Thus, the ability to overcome adverse selection and moral hazard problems varies among individuals, and these differences matter for explaining successful enterprise. The interesting issue is not that such problems exist, but that in spite of them, some individuals are able to secure resources from different resource controllers, often at very favorable terms, whereby considerable risk is shifted from the entrepreneur to the stakeholder. These differences in ability and the strategies used form an interesting part of the domain of entrepreneurship.*

Organization theorists have always argued that the economist's view of the world is a highly undersocialized one (Granovetter, 1985) that does not take into account relations of trust and support networks built

up over time by the entrepreneur. And in fact evidence is slowly accumulating that shows individuals employ a wide variety of social capital in the pursuit of a venture, especially in the early stages of a new firm (Aldrich & Fiol, 1994; Larson, 1992; McGee et al., 1995; Mosakowski, 1991; Ring & Van de Ven, 1992, 1994; Shan, 1990; Starr & MacMillan, 1990). Cooperative relationships based on trust and prior experience, or more broadly, social capital, do help reduce the adverse selection and moral hazard problems alluded to by economists.

The credible commitments provided by entrepreneurs to their resource suppliers as well as the use of social capital at start-up and during the inevitable crises deserve more attention. What forms do credible commitments or social capital take, how do they evolve, what is their relative effectiveness, and what are the trade-offs or costs associated with different strategies? Finally we must look at the ability of some entrepreneurs to forge relationships and induce investments even when credible commitments or social capital are low, for this differential ability may determine whether an entrepreneur is successful or not.

The concept of trust has a long history of research in the social sciences and has been examined from a variety of theoretical perspectives (see Gambetta, 1988). The general approach in the entrepreneurship literature has been that trust is a "lubricant" that facilitates cooperative exchange, especially under conditions of uncertainty, information asymmetry, and unobservable actions (Dasgupta, 1988). It enables entrepreneurs to overcome the lack of legitimacy (Stinchcombe, 1965) associated with new ventures and serves as a flexible and adaptive governance structure. Most of the literature in entrepreneurship implicitly treats the development of trust and trustful relations as costless and uniformly useful in all contexts. Developing trust and trustful relations, however, involves the expenditure of scarce resources (time, psychological and social energy, and perhaps even economic resources). The cost must therefore be brought into the equation. The question may be posed as "Under what conditions can we expect greater returns to trustworthy behavior on the part of entrepreneurs?"

Because of their costs, returns on trust and trustworthy behavior will be higher in some contexts (inefficient market conditions with weak institutional regimes to ensure honest behavior) than in others (efficient markets with strong institutional regimes to ensure honest behavior). Economic theory suggests that, in situations where information is rich and widely available, the scope for entrepreneurial profits is low (see

Kirzner, 1985; Wu, 1989 for standard arguments regarding this issue), and opportunities for cheating are fewer. These market conditions, combined with strong institutional regimes for rewarding honest behavior and punishing cheaters (e.g., enforceable contracts, Securities and Exchange Commission regulations, etc.), result in less scope for individual trustworthiness as a differentiating attribute for favorable treatment by resource suppliers. In this context it may not be economically justifiable for someone to invest scarce resources to build interpersonal relations. In short, information and institutional regimes that ensure good behavior are efficient substitutes for trust at the individual level.

Conversely, when high levels of information asymmetry are combined with weak institutional regimes for ensuring honest behavior (e.g., current conditions in Russia), the ability to signal individual trustworthiness may be an important advantage in the eyes of resource suppliers. In this context it pays to invest scarce resources in building social capital. Those who do so will have greater success in securing commitments from transaction partners (Low et al., 1994).

This simple example illustrates the richness and variety of inquiry that is possible while still preserving the distinctive element entrepreneurship provides to more general issues, such as social capital.

Returning to the relationship between entrepreneur and resource suppliers, I would like to highlight two other important questions. The first concerns financial investors, while the second concerns customers. Investors occupy a special place in entrepreneurship. Cash from investors, either in the form of debt or equity, is usually either converted into the non-liquid assets required for running the business or used for operating expenses. Once the cash has been spent or invested in non-liquid assets, investors are locked into the deal. Even if they wish to exit the relationship, say following a crisis, investors are stuck unless the start-up has enough cash flow to accommodate such exits, a situation that is very rare. Furthermore, since most start-ups lack a ready market for their equity (almost all begin as private enterprises, even those that go public), the assets of the early investors can often be recovered only through bankruptcy proceedings. This option is unattractive, because most new ventures are both asset poor and cash poor during their early years. Thus investors bear significant residual risk.⁴

Given the special role of investors, the field of entrepreneurship has been right to focus on the relationship between entrepreneur and investor. The supply side, however, has received less attention than the

demand side. We take it for granted that capital comes mainly from business angels and venture capitalists but rarely speculate about why these two distinct capital suppliers exist in the economy, with different prices and return expectations. Or, to ask the question differently, why doesn't one form drive out (or acquire) the other, perhaps the more inefficient, form? This leads to some interesting propositions about why these two distinct forms exist in the economy (see Fiet, 1992).

Consider the question from an entrepreneur's point of view. Given these two types of suppliers and different prices, which will the entrepreneur choose as the favored investor? One possibility is that just as there is diversity in ventures and entrepreneurs so too is there diversity in the capital supply industry. For example, venture capitalists, because they are portfolio investors, look for projects with greater uncertainty but potentially higher returns. In hyper-uncertain environments, the asymmetry of information between entrepreneur and investor is meaningless. What the entrepreneur knows that the investor does not cannot really hurt the investor. Furthermore, by setting very high hurdle rates, venture capitalists allow only entrepreneurs with high-risk projects to bid for capital which means the entrepreneur's inside information cannot hurt the venture capitalists since the project is already highly uncertain. The venture capitalist is able to separate serious entrepreneurs from non-serious entrepreneurs by the simple expedient of having contingent contracts, which specify that the second round of financing is contingent upon first round performance, or in other words, staged capital commitment.⁵ The result is that only serious entrepreneurs who have high-risk projects with significant upside potential will have the incentive to go to venture capitalists. The venture capitalist solves the information asymmetry problem by choosing only highly uncertain projects so that inside information becomes irrelevant, and solves the moral hazard problem by using only a staged commitment of capital.

Business angels in contrast add a different kind of value to the economy. Since they are not portfolio investors, their capacity to undertake highly risky projects is limited compared to venture capitalists. As a result they tend to select more certain projects. But when this happens both the information asymmetry and the protection of the investment, post-investment, become serious problems. What entrepreneurs know about a project or themselves, but the investor does not, can hurt the investor. Thus inside information becomes important for selecting projects. To overcome this problem, business angels must rely on social

capital. Business angels prefer entrepreneurs with whom they already have trusting relationships, or who come recommended by a trusted source. The business angel solves both the information asymmetry problem and the moral hazard problem by investing only with people they know and trust, and only in amounts that are small fractions of their total net worth.

Entrepreneurs who are fairly certain about the probability distribution of success (whether this certainty is justified or not is a different matter) and have projects with relative low risk exposure, will be more likely to obtain capital from business angels who know and trust them than from venture capitalists. On the other hand, entrepreneurs who have very little information about the probability distribution of success and have projects with relatively large risk exposure will be more likely to obtain capital from venture capitalists, all other things being equal.

This raises the question of how risk—especially downside risk (dead loss if the venture fails)—is allocated among stakeholders, a subject rarely addressed in entrepreneurship journals. Fundamentally, entrepreneurs vary in their ability to deal creatively with risk. Some may creatively package risk to make it insurable, others may have the ability to shift it to somebody else, while yet others may have the ability to creatively reduce the residual risk that cannot be insured or shifted. This differential ability may have a significant impact on the success of a start-up, as well as on the allocation of risk among stakeholders.

It is also interesting to speculate about who makes up the early, or first, customers of new, especially innovating ventures. And given the uncertainty about the output, what attracted these early adopters? Answering these questions will allow us to better understand how entrepreneurs create customer markets for untested products.

Differences between early and late adopters may also be understood by examining what I call entrepreneurship in the factor markets. Why think of entrepreneurship solely in terms of uncovering markets for new products? Why not also think of entrepreneurial discovery and exploitation of new developments in factor markets? Although Schumpeter (1976) included the discovery and exploitation of new raw materials and new combinations of resources in his definition of entrepreneurship, there is a tendency in the entrepreneurship literature to focus only on the exploitation of product markets. The discovery and exploitation of the profit potential of innovations in factor markets requires as much enterprise as the discovery and exploitation of product markets. The potential

for wealth creation may also be as great, since innovations in factor markets can enhance the scope or efficiency of entire industries. Therefore, by studying the early adopters of an innovation and their reasons for adoption we can find out who are most likely to be the first customers for a new product, or the outputs of a new enterprise. This question, although emphasized in the marketing literature, is largely ignored in the entrepreneurship literature.

MODES OF ORGANIZATION

Another critical decision for the entrepreneurs is how to "organize" relationships with resource suppliers in order to foster the development and execution of a new business. Stated differently, when there are several possible institutional arrangements for creating a future product or service (such as a new firm, a franchise or license arrangement, a joint venture, or a simple contractual agreement), why do entrepreneurs (either independent or corporate) choose a particular mode? And what are the consequences of this choice on the distribution of risks and rewards among the various stakeholders?

The strategy literature has placed great emphasis on how the choice of organizational mode influences performance. The choice of mode is considered important for improving transaction cost efficiencies (Coase, 1937; Williamson, 1975, 1985; Hennart, 1988; Mosakowski, 1991), reducing risk (Harrigan, 1986; Kogut, 1988; Mosakowski, 1991), improving competitive positioning (Borys & Jemison, 1989; Harrigan, 1986; Kogut, 1988; Venkatraman, Lawrence, & Koh, 1994), improving complementary synergies (Borys & Jemison, 1989; Harrigan, 1986; Kogut, 1988) and finally, influencing performance (McGee et al., 1995). The entrepreneurship literature has virtually ignored the question of choice among available alternatives, with a very few exceptions (e.g., McGee et al., 1995; Mosakowski, 1991; Shan, 1990).

The usual assumption has been that most (if not all) new business creation occurs within a hierarchical framework, either as *de novo* start-ups or as new entities within an existing corporate body. Even if this were empirically true (which casual observation suggests so, although there is no systematic evidence), a hierarchy is just one possible mode among several. Thus, we have still not answered why this mode is the predominant one that we observe in practice. At a more general level, we need a theoretical understanding of why a particular mode is optimal for a

given context. We are far from answering these questions satisfactorily, and yet they have significant implications for the generation of wealth (private and social), and more importantly for the distribution of both wealth and the risk attached to new business creation.

Several current theories deal with choice of mode. These theories fall into three broad categories: one emphasizes cost (transaction cost and agency costs) one emphasizes speed and market power (strategic behavior) and one emphasizes appropriability (resources and capabilities view of the firm). Each theory focuses on a single issue and develops it to its logical conclusion, but ignores the other two issues. In reality, choice is often a trade-off between cost, speed and protecting knowledge, especially because those factors often conflict with each other. The optimal structures thus depend as much on context as on any one particular issue, for example, transaction cost or appropriability. Choice of mode is a very fruitful area for research, especially because entrepreneurs have to balance transaction costs with both speed and the protection of core knowledge that gives them an advantage in the market place.

THE RELEVANT PERFORMANCE YARDSTICK

As I stated earlier, many journal contributors seem preoccupied with relative performance of firms. Relative performance is a meaningful benchmark in the strategy literature, because strategic management is concerned with differences in performance between rivals, and more importantly, with the sustainability of these differences over time and in the face of competition. Relative performance, however, while important, is not necessarily a meaningful benchmark in the field of entrepreneurship. Entrepreneurship is concerned with the discovery and exploitation of profitable opportunities for private wealth, and as a consequence for social wealth as well. Therefore, the relevant benchmarks for entrepreneurship are (1) the absolute level of economic performance that provides a return for enterprising effort, and (2) the social contribution of the individual's effort.

Superior performance relative to other firms is not a sufficient measure of success in the case of entrepreneurship because profits must exceed some minimum threshold in order to compensate opportunity seekers for their efforts. Just to break even, profits must cover compensation for bypassed alternatives (opportunity cost), lack of liquidity of investment (cash, effort and time), and as discussed by Knight (1921), a

premium for risk and a premium for uncertainty. Only the surplus above this minimum can be counted as the entrepreneur's reward. Results that fall below the sum of the above four components actually represent an economic loss for the entrepreneur, *even if the sum is far above rival firms' performance*. As we have already learned from the strategy literature, the source and durability of this surplus may arise from several factors. These include artificial monopoly rights accorded by patents or other government protection (monopoly profits), a head start because of some innovative element of the new enterprise (Schumpeterian profits), and the inability of others (due to various isolating mechanisms) to imitate, substitute, trade for or acquire the rare resources required to drive down the surplus (Ricardian profit).⁶ In the context of entrepreneurship, however, it is meaningless to talk about performance without talking about the components of the return on entrepreneurial efforts. These components are shown in Figure 1.

The second element of performance in the context of entrepreneurship is social wealth. As Schumpeter (1976) pointed out several decades ago (and Adam Smith much earlier) the personal profit motive is a central engine that powers private enterprise and social wealth. Entrepreneurship is particularly productive from a social welfare perspective when, in the process of pursuing selfish ends, entrepreneurs also enhance social wealth by creating new markets, new industries, new technology, new institutional forms, new jobs, and net increases in real productivity. This connection between private wealth-seeking and social wealth creation forms a distinctive and legitimate domain for the field of entrepreneurship. For this reason we need a measure of performance that is able to capture, simultaneously, the economic performance at the individual or firm level as well as social performance. This construct would be the most relevant, legitimate, and distinctive performance variable for entrepreneurship research. Indeed, I would go so far as to claim that explaining the behavior of this construct is the very *raison d'être* of the field.

When we bring social wealth into the performance equation, new questions appear at a different level of analysis. As Baumol (1991) has suggested, the supply of enterprising talent within a society (or firm) is not the problem. Rather this talent must be allocated among a limited number of roles. Some of these roles are productive and involve innovative and constructive entrepreneurship, while some of them are wasteful rent seeking behavior and crime (Baumol, 1990; and Murphy, Schleifer, & Vishny, 1992). The concern is therefore to identify which conditions

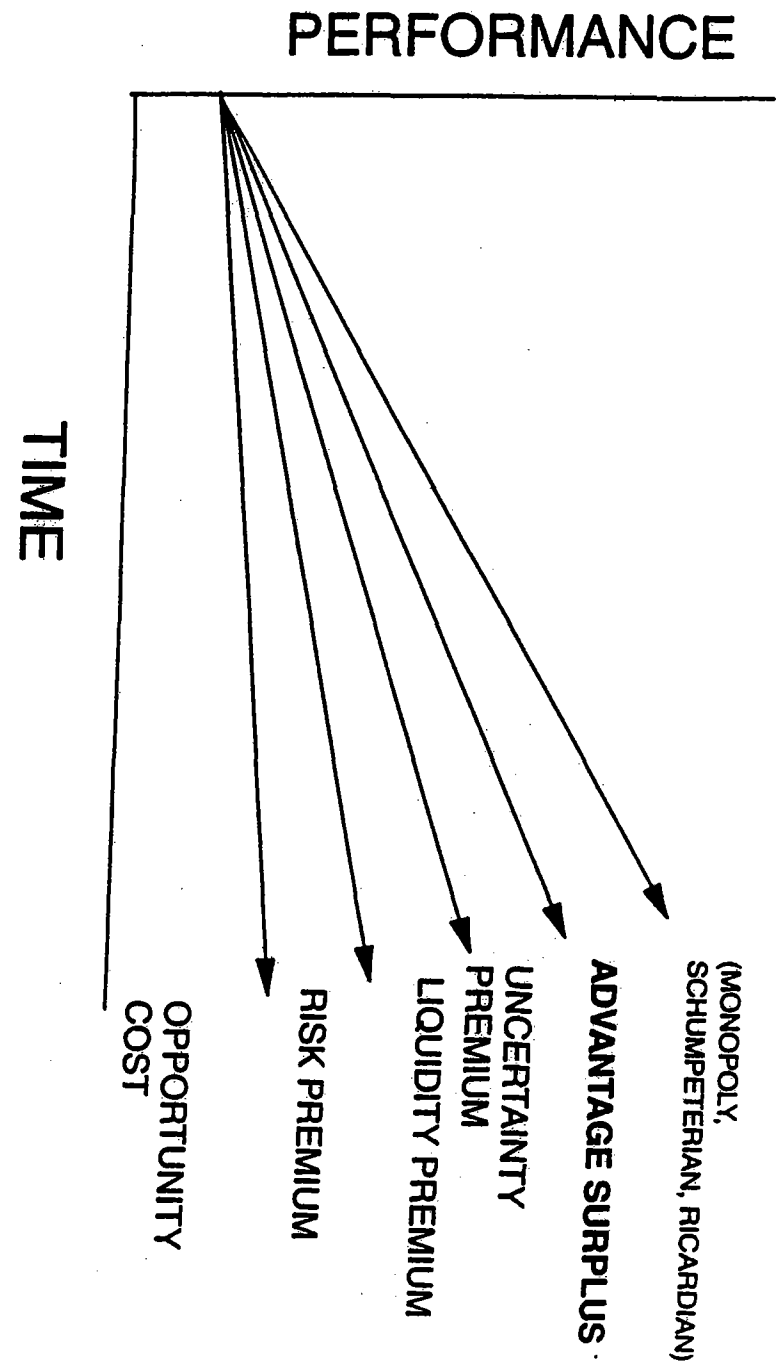


Figure 1. Abnormal Profits: Components.

determine in which direction entrepreneurial talent in society (and perhaps firms) will move—positive or negative entrepreneurial behavior. The central hypothesis is that the set of social and political rules, incentive structure, incentive distortion, and individual backgrounds dictate how talent will be allocated to different aspects of entrepreneurship.

At a macro level research on this topic would allow us to answer many important questions. What determines, and how do we influence, the level of demand and supply of enterprising individuals in society? What determines the allocation of enterprising talent into rent-seeking (or parasitical) activities and productive activities? Does talent vary across countries and if so why? Does this vary across time and why? Finally, what are the implications of this research for public policy?

Most of the questions outlined in this chapter may be approached from many disciplinary vantage points—psychological, sociological, socio-psychological, socio-biological, economic, ethical, and moral-philosophical. Our sister fields in business schools have examined none of them, and I cannot think of a more suitable and legitimate field of inquiry for entrepreneurship to “appropriate.”

CONCLUSION

Entrepreneurship is an exciting field of study with tremendous promise, great relevance, and significant and profound intellectual problems. Its future is limited only by our inability to build cumulative knowledge. We have been held back because we do not share a well-articulated underlying theory of entrepreneurship or wealth creation and we often approach the phenomenon from incompatible theoretical viewpoints—economic, social, and psychological, and use different levels of analysis—individual, group, and population. The usual theoretical structures often do not seem to work for explaining entrepreneurship. But we have no well-developed, or reasonably articulated alternatives to take their place. Indeed, there are some who claim that finding systematic patterns, or even a theory of wealth creation or entrepreneurship is impossible.

I believe that even if we cannot build on underlying theoretical structure, the task of accumulation can still proceed if the invisible college shares a consensus as to what constitutes entrepreneurship's legitimate domain. The connection between the pursuit of a future market and the creation of social wealth offers both a distinctive voice and a specific worldview, and holds the potential for cumulative work.

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NOTES

1. Markets already exist for deciding the prices and quantities for some goods that will come into existence in the future. Examples include the various commodities markets, futures markets in currency, commodities, stock indexes, and so on. However, no such markets exist for many consumer and capital goods that will only be discovered and created in the future. The absence of such markets have to be explained (Arrow, 1974), theoretically and empirically, and this constitutes one part of the intellectual domain of entrepreneurship.

2. Economists refer to this as the adverse selection problem (Akerlof, 1970). Overcoming this problem imposes extra costs for revealing credible information, writing in all kinds of contingencies in contracts, and at an extreme, driving better quality entrepreneurs and resource suppliers from the market (as in the case of newly emerging market economies such as Russia) unless some other mechanism exists to reduce such costs.

3. Economists refer to this unobservability problem and the incentive to use others opportunistically as the moral hazard (and double moral hazard) problem (Arrow, 1971). Overcoming the moral hazard problem also introduces significant post-contract costs, unless some other mechanism exists to reduce such costs.

4. While all stakeholders in a new enterprise hold some residual risk, to the extent they have specialized assets dedicated to the new enterprise that cannot be applied to any other endeavor, investors arguably hold more of residual risk than most other stakeholders.

5. A non-serious entrepreneur will not have the incentive to bid for the venture capitalists capital because he knows before hand that future capital is contingent upon past performance.

6. See Alchian (1991) and Peteraf (1993) for good discussions of some of these issues.

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