Towards a Theory of Entrepreneurship

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The many valuable contributions of Michael Levenhagen and Howard Thomas are gratefully acknowledged.
Executive Summary

For research purposes, a theory has been defined as "a set of interrelated constructs (concepts), definitions, and propositions that present a systematic view of phenomena by specifying relations among variables, with the purpose of explaining or predicting the phenomena". Empirical research attempts to observe the different variables in the real world and explore the relationship among them.

Over two hundred years of study of entrepreneurship have provided many definitions of the word "entrepreneur", but no theory of entrepreneurship that would comply with the above definition. Indeed, the search for a best definition may have impeded the development of theory.

Many attempts have also been made to identify the unique traits of an entrepreneur. Results have been interesting, but should perhaps be considered to be directed towards defining the variables and their relationships within the domain of psychology.

The primary interest in entrepreneurship seems to be related to the economic outcomes that entrepreneurship provides. Success strategies, reasons for the success of an entity, are one of those outcomes. Another such outcome is the formation of a new venture.

However, the findings of empirical entrepreneurship research that relate to economic outcomes seem to be loosely linked. The missing linkage may be missing theory.

The following tentative economic outcome-based theory, extracted from extant literature, is offered in the hope that it will better explain and predict the phenomena of entrepreneurship:

"A person will tend to (a) start a new venture, or (b) develop success strategies for an existing entity under conditions of:
1. Task related motivation, and
2. Expertise, and
3. Expectation of personal gain, and
4. A supportive environment."
In spite of the number of published papers that might be considered to relate to theory, many writers have observed that a theory of entrepreneurship has not yet emerged. However, all theory related papers provide a rich background of ideas. These theory papers can be classified into broad categories.

Perhaps the oldest category, not really theory, is concerned with the definition of the word "entrepreneur". Another category might be classified as the trait approach, i.e., the study of the psychological traits of people who are identified as entrepreneurs. A third category is the study of success strategies, reasons for success of new and existing entities. A fourth category is the study of the formation of new ventures.

DEFINITIONAL LITERATURE MAY HAVE IMPEDED THEORY DEVELOPMENT

For some reason(s), writers seem to have become somewhat obsessed with defining the word "entrepreneur". The term has been used for over two centuries, but writers tend to slightly extend or revise the definition. Bygrave (1989) observes that entrepreneurship scholars are still bickering over a working definition of entrepreneurship, and suggests that the lack of precision in the definition of an entrepreneur may be a contributing factor to the lack of robust entrepreneurship models.

The discipline of Business Policy and Strategy, and perhaps other emerging disciplines as well, shares a similar definitional deficiency. Camerer (1985) identifies one symptom of the disease causing dissatisfaction with policy research as "Concepts are often ambiguous and their definitions are not agreed upon." His recommended cure, not the one suggested in this paper but one which deserves consideration, is the use of deductive models with more precise definitions even at a loss of realism.

Perhaps that tendency to want to invent a better definition has misdirected research effort about the more useful topic of a theory of entrepreneurship. Priorities may have been reversed. It is possible that a reasonable theory might solve the definitional problem of "entrepreneur" or render it somewhat irrelevant.

SELECTIVE REVIEW OF RELEVANT LITERATURE RE: DEFINITION

Amit, Glosten and Muller (1990) select and interpret a
number of twentieth century authors to explain the entrepreneur and entrepreneurship. They interpret Drucker (1985) as relating entrepreneurship with the act of innovation that involves endowing existing resources with new wealth-producing capacity. They interpret Leibenstein (1968) as describing the entrepreneur as one who answers market deficiencies and marshals all resources to produce and market a product. Schumpeter (1942) is interpreted as seeing the entrepreneur as a leader and contributor to the process of creative destruction. Kirzner (1985) is believed to view the entrepreneur as one who perceives profit opportunities and initiates action to fill currently unsatisfied needs or to improve inefficiencies. Knight (1921) as interpreted by Bewley (1989) is viewed as seeing the entrepreneur as a person with an unusually low level of uncertainty aversion.

Schumpeter (1942,1947), often quoted, states (p. 132)
".....the function of entrepreneurs is to reform or revolutionize the pattern of production by exploiting an invention or, more generally, an untried technological possibility for producing a new commodity or producing an old one in a new way, by opening up a new source of supply of materials or a new outlet for products, by reorganizing an industry and so on."

Building on the Schumpeter description, Kirzner (1985) recognizes "the central role played by alertness of the entrepreneur" (p. 7), e.g., the discovery of possibilities hitherto overlooked, the "speculative ability to see into the future". Further, the discovered opportunities "must offer gain to the potential discoverer himself" (p. 29). Then "man acts, in the light of the future as he envisages it, to enhance his position in that future." (p. 55).

Hebert and Link (1988) trace the history of the term "entrepreneur" and the evolution of its different meanings. It first appeared in the writings of Richard Cantillon in 1755 who used the term to describe "someone who exercises business judgment in the face of uncertainty" (p. 21). Modern nuances of the meaning have been influenced by a host of writers. A few of the more influential ones include J. B. Say (1767-1832), J. H. von Thunen (1785-1868), Leon Walras (1834-1910), Alfred Marshall (1842-1924), Frank Knight (1885-1972), Joseph Schumpeter (1883-1950), Ludwig von Mises (1881-1972), Israel Kirzner, and Harvey Leibenstein.

Hebert and Link offer their own definition as "someone who specializes in taking responsibility for and making judgmental decisions that affect the location, the form, and the use of
goods, resources, or institutions" (p. 155). They posit that military and political life provide as much scope for entrepreneurship as economic life.

The term "intrapreneur", generally used to describe an entrepreneur within an existing entity, might be useful if entrepreneurship was restricted to the formation of new ventures. The term may be used most frequently in organizational theory literature at the present time.

SELECTION OF DEFINITION

Policy makers, researchers, and teachers do need a commonly accepted definition that distinguishes an entrepreneur from a non-entrepreneur. The term has been used for over two centuries, so an entirely new definition would not be acceptable. The term is used in academia and in commerce, by the media and ordinary persons in ordinary conversation. Academics would seem to have the greatest obligation to be precise. Academic acceptance of one of the definitions that have already been offered might be the prudent action at this stage. In any event, the search for a definition need not impede the search for a theory of entrepreneurship.

TRAIT APPROACH

Sandberg and Hofer (1987) studied new venture proposals submitted to venture capitalists, directing their study towards new venture performance. They rejected the model that success is based solely on the characteristics of the entrepreneur, and found support for the hypothesis that success is also influenced by industry structure and venture strategy. They suggested that research be extended beyond personality and psychology.

Gartner (1989) presents a convincing case that the trait approach, i.e., the search for characteristics and traits of the entrepreneur, is unlikely to help us understand the phenomenon of entrepreneurship. He suggests that entrepreneurship is the creation of new organizations, and that entrepreneurship ends when the creation stage of the organization ends. He recommends the study of the behavior of entrepreneurs to understand the process by which new organizations come into existence.

Successful entrepreneurs are often interesting people. Americans have long been interested in Horatio Alger type fiction where the hero achieves success through self-reliance and hard work. It is not surprising, therefore, that the focus of many
papers has been directed towards identifying the characteristics of the entrepreneur.

One test of the worth of a theory is surely the usefulness of the findings of the research that it generates. Society’s interest in entrepreneurship seems to be primarily economic, the fostering of successful business enterprises which provide new products or services, or old products and services in new and better ways. Success strategies can be modified and emulated by others. Conditions which encourage the formation of new ventures can be developed in other environments.

Understanding entrepreneurial traits may be useful for psychologists for therapeutical purposes, but it is difficult to envision how that understanding could significantly improve our economic well-being. Therefore, it is suggested that theory regarding the traits of entrepreneurs is in the psychological domain, and need not be considered in the development of entrepreneurship theory in the economic domain.

THEORY BUILDING

Kerlinger (1973) defines a theory as "a set of interrelated constructs (concepts), definitions, and propositions that present a systematic view of phenomena by specifying relations among variables, with the purpose of explaining and predicting the phenomena" (p. 9). Most papers that allegedly encompass some aspect of entrepreneurship theory do not seem to follow that approach.

Why have so few attempts been made to specify relations among variables to explain or predict entrepreneurship? There could be many reasons. One might be because entrepreneurship is such a ambiguous and complex concept. It means different things to different people. But that line of reasoning would seem to encourage theory development in order to strip away some of the ambiguity.

Making empirical observations without benefit of theory is sometimes disparagingly described in terms like "data-mining". But a completely different reason might be the concern that articulation of an inadequate theory would tend to bias the interpretation of empirical observations. That line of reasoning has been expressed by some who emphasize that entrepreneurship research is in its early stages and who may prefer to interpret findings within some framework other than theory.
Hornaday and Churchill (1987) express the opinion that the accumulation of past research has produced sufficient empirical data to allow some development of theoretical constructs. However, that development has been slow.

Casson (1982) explains that economic theorists analyze the allocation of scarce resources while economic historians use a descriptive approach to develop a taxonomy. Those two approaches have never been integrated to form a theory of entrepreneurship. He then offers a theory of the entrepreneur (but not entrepreneurship) by explaining functions based on the definition "An entrepreneur is someone who specializes in taking judgmental decisions about the coordination of scarce resources".

Koller (1988) observed two processes by which entrepreneurial ideas are acquired. The first as a result of an explicit search for opportunities, and the second as a result of a chance observation of an opportunity that was attractive. What theory with what variables would have predicted or explained the new ventures or the new success strategies that were created by either or both processes?

Baumol (1990) observes that the types of innovation that are attributed to entrepreneurs by Schumpeter have been shown in some form by different classes of entrepreneurs over the recorded history. He points out that their behavior patterns were different in different eras, e.g., in Ancient Rome, Medieval China, the earlier Middle Ages, the later Middle Ages, the Fourteenth Century, the Eighteenth Century, and the modern era. He believes that entrepreneurs are always present. However, how entrepreneurs act depends heavily on the rules of the game, the reward structure in the economy. Changing the rules can modify the composition of the class and the number of entrepreneurs, but more importantly, changing the rules modifies their behavior. The rules of the game are therefore hypothesized to be an important variable in explaining entrepreneurship.

Bygrave (1989) notes that research about entrepreneurship is in its early stages, and that so far it has mostly borrowed its methods and theories from other sciences. Those other sciences tend to have a bias that there is incremental progress where things happen for a reason, and lead to a system where everything fits. Progress can be described by smoothly changing, linear and deterministic models. That type of model does not describe entrepreneurship’s disjointed events that disrupt stability. Therefore, at this pre-theory stage he suggests that
entrepreneurship research be directed towards empirical observations and longitudinal studies, using existing frameworks for guidance. As patterns emerge from those studies, partial theories can be built, and perhaps at some time a great theory of entrepreneurship can be built from partial theories.

In a companion article, Bygrave (1989) examines the entrepreneurship process to see if it has characteristics that are amenable to the mathematics of catastrophe and chaos. He offers the following mathematical characterization of the entrepreneurial process:

1. The entrepreneurial event is a discontinuity.
2. The discontinuity ranges in size from a quantum jump to a tiny increment.
3. The antecedents to the event comprise many factors.
4. The event is triggered by changes in the antecedents.
5. The changes are usually tiny increments rather than large breakthroughs.
6. The event is unique, cannot be exactly duplicated.
7. The process is unstable, outcomes are very sensitive to small changes to the inputs.
8. It is a holistic process.

He concludes that it would be hazardous to try to apply catastrophe theory to entrepreneurial research. However, chaos may offer some hope. At certain initial values the logistic difference equation for the growth of a population produces a chaotic region that appears to Bygrave to be analogous to entrepreneurship. He doubts that precise equations can ever be provided, but expects catastrophe and chaos to provide useful metaphors for the entrepreneurial process.

Rosa and Bowes (1990) observe that entrepreneurship is no different from a large number of other complex concepts that defy a simplistic or universal definition. They believe that some of the research on which a theory of entrepreneurship may be based is seriously flawed. From the social anthropology viewpoint, they suggest that new insights into entrepreneurship "are most likely to come through adopting a less ethnocentric, a more empirical and a more holistic approach" (p. 19).

Johannisson and Senneseth (1990) argue that the inherent character of entrepreneurship creates so much ambiguity that efforts to create a consensus model of entrepreneurship may be in vain. Rather they suggest study of five paradoxes of entrepreneurship, i.e., independence v. dependence, process v.
personal attributes, revolution v. evolution, vision v. action, and social v. business orientation. They believe that resolution or cementing of one or more of the paradoxes will add insight and understanding, important objectives of theory.

SUCCESS STRATEGY THEORY

A separate academic discipline generically described as "Strategy" has emerged within the last several years. Many of the activities and thought patterns are frequently described as entrepreneurial.

Rumelt (1984) alleges that a firm's stability and profitability fundamentally depend upon entrepreneurial activity. His theory of strategy: "A firm's strategy may be explained in terms of the unexpected events (ed: read Schumpeterian discontinuities) that created (or will create) potential rents together with the isolating mechanisms that (will) act to preserve them".

Another strategy related definition: "Managers describe entrepreneurship with such terms as innovative, flexible, dynamic, risk taking, creative and growth oriented." (Stevenson and Gumpert, 1985). Entrepreneurial managers think in terms of seizing opportunity, finding resources and gaining control in contrast to administrators who think in terms of husbanding resources and reducing risks.

Bird (1988) observes that "entrepreneurial intentions are aimed at either creating a new venture or creating new values in existing ventures". In addition to identification of a number of desirable traits for entrepreneurs, she hypothesizes some success strategies. As compared to unsuccessful entrepreneurs, the successful ones will spend more time thinking about the future and the present and less about the past; will better align their needs, values and beliefs with the new venture concept; and will develop skills in team building and reward collaboration among employees.

Venkataraman, Van de Ven, Buckeye and Hudson (1990) propose a process model on how new and small organizations may fail, based on an empirical study of ten educational software companies. Such firms often use transactions with key external constituencies to attract needed resources, making a set of transactions that are tightly coupled. When any one transaction fails, like the loss of a key customer, the set often collapses because the firm has inadequate slack to adapt to the new
Slack availability and the tightness with which transactions are coupled would therefore seem to be significant variables in the success/failure explanation or prediction.

Stevenson and Harmeling (1990) argue that entrepreneurial managers need a more chaotic theory. They allege that "much of the present theory used to explain corporate entrepreneurship is based upon an implicit assumption that we are examining a set of equilibrium-based phenomenon". (p. 2) They argue that theories of equilibrium are based on assumptions that the effects of small changes will be relatively minor on the system. Chaotic theories, in contrast, recognize that small changes in initial conditions or inputs can result in major changes in outcomes, and may therefore be more relevant for the study of entrepreneurship. Most observers would probably agree that the discontinuities of entrepreneurship appear to share some of the characteristics of chaos.

Duchesneau and Gartner (1990) acknowledge that "luck" seems to be one factor in success. They studied 13 successful and 13 unsuccessful small young firms in the same industry, but could offer no clear-cut prescriptions that are guaranteed to work. In terms of broad descriptions of the successful group, the lead entrepreneur seemed to be a "street smart" person who learned from mistakes, the start-up strategies were based on a broad clear vision with ambitious goals, time was allocated to planning, outside sources of information and professional advisors were used, organizations appeared to be flexible, participative and adaptive. Successful firms started with more capital that unsuccessful ones. As they acknowledge, their observations tend to coincide with prescriptions offered by a number of management writers.

Spender (1990) believes strategy is the practice of true entrepreneurship, and that means focusing on the process of dealing with uncertainty. He suggests that uncertainties involving incompleteness and irrelevance are dealt with by allocative entrepreneurship, e.g., better data collection tools and more powerful models. Uncertainties involving indeterminacy and incommensurability call for creative responses from Schumpeterian type entrepreneurs, e.g., adding discontinuities into strategy. Spender's classification illustrates the difficulty of classifying the functions of management. Actions that involve allocative entrepreneurship might be classified by some as administrative instead of entrepreneurial.

NEW VENTURE FORMATION THEORY
Some writers restrict entrepreneurship to the creation of new ventures. Almost all would agree that forming new ventures is one of the possible outcomes of entrepreneurship.

Rumelt (1987) defines entrepreneurship as the creation of new businesses, ones that do not exactly duplicate existing businesses but have some element of novelty. He suggests that entrepreneurial activity should be determined by the availability of entrepreneurial insights, the potential returns, and by the entrepreneur's ability to attract the requisite capital. Entrepreneurship is encouraged when the entrepreneur can resist the appropriation of entrepreneurial rents by powerful outsiders with whom the entrepreneur must work, and when isolating mechanisms exist which provide first-mover advantages. Entrepreneurial managers have incentives to leave their employer and start new ventures because institutional myopia tends to prevent incentive contracts that tightly link future returns to the innovator's wealth and reputation.

Murray (1984) defines entrepreneurial strategy as a strategy of fundamental change. He sees environmental change as the primary factor stimulating entrepreneurial behavior. However, the individual or collective purpose of an entrepreneur or entrepreneurial group, culminating in the formation of a new venture, can start the chain of causation in environmental change. In starting new ventures, Murray suggests that entrepreneurs are driven by (a) a high need to achieve and/or a high need for independence and power, (b) a considerable knowledge of the industry of the new enterprise, and (c) a triggering experience, the perception of an opportunity or displacement from a career path.

Gartner (1985) offers a four dimensional framework to describe new venture creation, i.e., the individuals, the organization, the environment, and process. He identifies many variables, 8 about the persons involved in starting a new organization, 17 about the kind of firm that is started, 22 about the environment, and 6 about the actions undertaken to start the venture.

Knight, Dowling and Brown (1987) offer the theory that new venture creation is fairly regular and predictable and that three forces potentially stimulate the growth of new firms in an industry, e.g., new technology, new markets, and deregulation or shifts in government regulation. They postulate that variables such as environmental conditions, market forces, government
policy, life cycles, and innovation can play important roles in the growth of new firms.

Edward H. Rockey (1986) reports that some entrepreneurs use visualization for various phases of business start-ups. Is vision, in some form, an important variable in entrepreneurship theory?

Bearse (1982), Schell (1983) and Mauer (1985) consider that the culture of the community is important to entrepreneurship. Is community culture another variable?

Levenhagen and Thomas (1990) make several observations based on in-depth interviews that were conducted with 13 software entrepreneurs to attempt to determine the reasons for their leaving existing employment and starting up new organizations. These entrepreneurs felt a conviction and dedication to the values embodied in some core task, a feeling that was in conflict with the values of their previous employer. Profit maximization goals were not primary motivations for start-ups. And, in terms of risk, the risk of not achieving some non-monetary utility embodied in the core task outweighed any potential loss of human or financial capital.

WHAT NOW?

To some extent the conclusions and findings from the above studies that were selected to be summarized seem to be loosely linked. They seem like fragmented pieces of a puzzle that is not yet fitted together in a whole. They leave the reader with a vague feeling of dissatisfaction. Can an entrepreneurship theory, even if armchair induced and ambiguously ill-specified (Camerer 1985), provide some useful degree of explanation and prediction?

RELATE THEORY TO OUTCOME?

Gartner (1990) used a three phase Delphi technique to explore the meanings that current researchers and practitioners have about entrepreneurship. Two major viewpoints were identified. One focused on characteristics like innovation, growth and uniqueness. The other focused on outcomes like profit and creating value. He concluded that a single definition of entrepreneurship has yet to emerge, and that it is important for persons who use the word to say what they mean.

Success strategy theory and new venture formation theory
are directed towards economic outcomes. One outcome is the formation of a new business venture. The other outcome is success, success of either a new or an existing venture. Both kinds of outcomes and the behaviors that create those outcomes are labeled "entrepreneurial" by a significant number of writers. Any attempt to restrict the use of "entrepreneur" and its derivatives to only one of these contexts is certainly inconsistent with current practice.

Are the separate outcomes of achieving success and creating new ventures related? How different and how similar are they? They seem to be quite different, yet both outcomes reflect a discontinuity and have the potential of creating significant economic consequences. Could a single set of interrelated constructs specify relations among identified variables to explain or predict these two outcomes?

If a set of interrelated constructs can indeed specify relationships among identified variables to explain and/or predict entrepreneurial outcomes, what are the minimum sufficient conditions? Perhaps the following begins to capture a tentative economic outcome-based theory based on the extant literature:

A person will tend to (a) start a new venture, or (b) develop success strategies for an existing entity under conditions of:

1. Task related motivation, (some vision or social value imbedded in the basic task itself that motivates the initiator to act), and

2. Expertise, (present know-how plus confidence to be able to obtain know-how needed in the future) and

3. Expectation of gain for self, (economic and/or psychic benefits), and

4. A supportive environment, (conditions that either provide comfort and support to the new endeavor, or that reduce discomfort from a previous endeavor).

IMPLICATIONS OF AN ENTREPRENEURSHIP THEORY

The potential research implications of a credible entrepreneurship theory are enormous. Consider the hundreds of
studies and their contributions towards the understanding (still imperfect) of financial markets that followed the efficient market theory and the capital asset pricing model. The articulation of these enormously significant theories appear to have spurred research to an incredible extent.

Teaching and research are interrelated. These financial market theories have significantly influenced teaching in finance, economics, accountancy, and related fields. The body of knowledge in any area grows from empirical research. The teaching of entrepreneurship-related topics would expand and improve as the frontiers of knowledge are pushed forward by research.

Public policy and practice could both lead and follow research findings. As an understanding of the relationship of the variables develops, practice would change to attempt to bring about the desired creation of new ventures and the implementation of effective success strategies. The effects of the changes in practice would provide further data for study.

RELEVANT RESEARCH QUESTIONS

This paper concludes with some interesting questions. Identifying the most relevant and challenging entrepreneurship research issues and questions is beyond the scope of this work, but posing some of the questions seems desirable. A complete list would obviously include better articulation of theory and identification of variables. The list might also include the following:

1. How are entrepreneurial opportunities recognized? Why aren't they observed by more people? How does entrepreneurial vision differ, if at all, from leadership vision exhibited by successful managers?

2. How does the recognition process differ in "discovery-push" opportunities from "need-pull" opportunities? Does the conscious search for actions to satisfy recognized needs focus vision in a different way than the search for opportunity to exploit a discovery?

3. When do businesses start? What kind of market conditions attract new firms? What role do opportunity costs play?

does a cluster start?

5. What cues at time of start-up distinguish firms with high-growth potential from those with low-growth potential? Do either the high-potential or the low-potential firms have observable distinguishing characteristics?

6. How do entrepreneurial start-ups become large established businesses? How do large established businesses maintain or lose their early entrepreneurial characteristics? Is the successful transition process somewhat common across all firms, or is it highly context dependent?

Each entrepreneurship researcher would probably suggest a different group of questions. However, information and conclusions about the above questions would provide insight that all would find exciting.
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