Economics and entrepreneurship essay examples

Business, Company

\n[toc title="Table of Contents"]\n

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Someone who has the initiative to organize a venture for taking benefit of an opportunity is an entrepreneur. He is a decision maker and his decisions involve what, how, and how much of products or services will be produced.

Entrepreneurship is one of the most important fields within several key sectors such as economics, finance, management, and law. However, even today and even with the recognition of the importance of entrepreneurship as a primary driving force of the " market", there is very little consensus about how economics incorporates entrepreneurship into its overall theoretical framework. Hence, there is no single economic theory that explains entrepreneurship succinctly.

It is of utmost importance however, that an understanding of entrepreneurship and its relationship with economic theories be developed, as a validation of pluralist economic education.

The purpose of this document is to examine modern perspectives that have been developed to explain entrepreneurship under existing economic thought. By doing so, this paper seeks to frame entrepreneurship in real world economic light.

Entrepreneur: The Fourth Factor of Production

Economic theory describes the firm as that which is bound by the factors of production. Factors of production are land, labor and capital, and the scarcity of these factors is the cornerstone of modern economic thought. The classical economic framework of Adam Smith and David Ricardo, the economic Marxian philosophy, and the precursor of modern economic theories do not clearly identify entrepreneurship as a factor of production. However, it is within this “ scarcity of factors of production” that entrepreneurship is recognized, as the fourth factor.

According to mainstream economic theory, people will always be looking out for opportunities to improve their economic position. Hence, unlike the first three factors identified, entrepreneurship is a factor that has infinite supply (also based on the infinite needs and wants of the individual). The infinity of supply of entrepreneurship has made entrepreneurship’s importance less than the first three factors as well, hence the immature development of any economic theory encapsulating entrepreneurial activity.

Mainstream economics also make a critical assumption about entrepreneurs. In mainstream economics, entrepreneurs organize factors of production and have “ complete information” about the availability and quality of factor inputs, all possible permutations of combinations of factors, and buyer’s demand.

In the real world, an entrepreneur would be lucky enough to have complete information on one of those key items. The entrepreneur’s recognition of a business opportunity leading to the establishment of a firm is a unique process in itself. Mainstream economics does not acknowledge that unique process of opportunity identification and assumes that business opportunities are automatically recognized and accessed. Secondly, an entrepreneur’s decision-making process on the disposal of factors of production is another unique process. Again, mainstream economics assumes that the methodology of an entrepreneur to identify, combine and dispose factors of production is automatic but in the real world, this decision often makes or breaks entrepreneurial activity.

The second concept is how the entrepreneur decides on the best way to identify, organize, utilize and deploy productive resources. This decision-making ability is what separates entrepreneurs, with those being more effective, efficient and inventive often succeeding. The idea of competitiveness is not within the general framework of mainstream economics, because it assumes fair and equally efficient firms.

Entrepreneur: Finding Opportunities in Inefficiency

Mainstream economic theory assumes that firms will efficiently use its resources. However, Harvey Leibenstein coined the phrase “ X-inefficiency” or that state wherein firms use resources inefficiently and as a result, the cost per unit of output of a firm is higher than it should be.

This inefficiency is mirrored as an opportunity for an entrepreneur. If an entrepreneur can identify, solve and manage the solution leading to a reversal of inefficacy, then he has identified a way to make his economic position better.

One example of solving efficiency is in identifying the shortcomings of labor, as a factor of production. Laborers are hired to perform a particular task, and compensated for doing so. Labor is not compensated for higher levels of effort but is often penalized for lower levels of effort. An entrepreneur therefore must find a way to motivate labor to provide output that is close to its optimum level of effort. Doing so gives the entrepreneurial firm a competitive edge.

Finally, the concept of X-inefficiency is based on one clear assumption, that the entrepreneur is aware of the inefficiency of rival firms, so much so that the entrepreneur recognizes and acts on the opportunity. This “ awareness” however, is not discussed in Leibenstein’s theory of firm inefficiency.

Entrepreneur: Thriving in Disequilibrium

Austrian economists Friedrich von Hayek and Israel Kirzner have looked at the awareness of entrepreneurs about rival firm’s inefficiency as a way of understanding how markets work. These economists believe that a market that is in disequilibrium must be understood more than a market at equilibrium. A market in disequilibrium will generate active decisions by market participants, including the “ entrepreneur” who thrives in such condition.

An entrepreneur is both an agent of disequilibrium and an agent of equilibrium. Disequilibrium starts when an entrepreneur identifies and accesses market information that is superior to rivals. This information is then communicated to its customers thus creating competitive advantage for him. The competitive advantage causes the market to be in disequilibrium, that is, entrepreneurs and customers have been given cost or price incentives to change their activities and behavior.

Austrian economics is concerned with explaining market movements from disequilibrium to equilibrium, identifying entrepreneurship as an activity that happens automatically in the market.

Entrepreneur: The Innovator

The Austrians believed that entrepreneurs activate during periods of disequilibrium. Joseph Schumpeter believed that entrepreneurs destroy market equilibriums. Schumpeter believes that entrepreneurs know what to do with scarce resources, and those are to introduce new goods or new quality of goods, new way or producing goods, new way of opening markets, finding new sources of raw materials and reorganizing industry structures. Doing so makes an entrepreneur an innovator, according to Schumpeter.

Schumpeter’s view is limited by the non-recognition of finance as part of the entrepreneurial process. He believed that entrepreneurs and capitalists are compeletely separated, and has chosen to frame his economic concept without providing importance to such interaction. In the real world, an entrepreneur requires finance to actualize his ideas, so why remove it from the theoretical framework?

Entrepreneur: the Specialist, Judgmental Coordinator

British economist Mark Casson's theory is that entrepreneurs are judgmental coordinators of scarce resources. His theory identifies the entrepreneur as a specialist in this field, thereby having comparative advantage as a core capability.

Casson further identifies two qualities that all entrepreneurs must have, that being imagination and foresight. Imagination is the perception of alternative ways resources can be used while foresight is a complement to imagination because information is scarce and actualizing imaginative vision requires practicality.

Secondly, an entrepreneur is judgmental. He makes decisions based on objective criteria, differing perceptions interpretations and access to different information. These differences enable an entrepreneur to act when others cannot do so. At this point, the entrepreneur becomes a coordinator of activities.

Entrepreneurs coordinate scarce resources to provide goods or services identified. Similar to the two previous concepts, entrepreneurs are agents or change but are a consistent, on-going process and not a incidental occurrence. Entrepreneurs are market makers and not merely market participants.

Entrepreneur: Constructor of Connections

The entrepreneur as a constructor of connections takes its cue from philosopher-economist George Shackle, who believed that new ideas could be combined in a variety of new ways. Hence, the theory of an entrepreneur being a constructor of connections is a combination of the ideas of Kirzner, Schumpeter, Leibenstein and Casson.

This theory recognizes the entrepreneur as one who is seeking to find and profit from new opportunities, by actively constructing them. They do so by trying to understand how potential customers make decisions. This involves creating something not from scratch, but from a connection of existing elements. An entrepreneur sees possible connections and goes after the opportunity, using an innovative process that we now believe drives the economies of the entire planet.

Conclusion

In economics, there is no single theory that describes entrepreneurship. While entrepreneurial spirit drives economies, the absence of a comprehensive economic understanding of entrepreneurship is not surprising. Mainstream economic theories examine equilibrium markets, detaching the role of the players in the development and movements within markets. Subsequent theories focused on the specific market scenarios, still not on the whole-range of entrepreneurial thought involved in making decisions and accessing opportunities.

However economics recognizes the importance of entrepreneurship, leading several key economic theories to other fields that understand its more psychological nature such as business management and law. In addition, there are many other topics that have yet to be addressed but are necessary for future research. These areas of interest are:

Determining the real effects of entrepreneurship to the rest of the economy and society as a whole - how much benefit to the society does entrepreneurship generate?

Is there value in creating regulations (laws and policies) for entrepreneurs? How has existing policy affected entrepreneurship?

Is there really discrimination in credit markets against entrepreneurs?

What is the impact of imperfect competition on entrepreneurship?

These topics about entrepreneurship not only challenge conventional economic norms, they also validate economic theories and by themselves have intrinsic values of interest.

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