# Opportunity Discovery, Opportunity Exploitation, and Economic Organization

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August 2007

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## Linking entrepreneurship and economic organization

- Two largely independent literatures
  - Dominant theories of economic organization – TCE, agency theory, GHM, RBV – rarely mention the entrepreneur.
  - Entrepreneurship literature says little about the firm: Does the entrepreneur need a firm? What would this firm look like?
- Phenomena to be explained
  - ToF: existence, boundaries, internal organization, growth
  - Entrepreneurship: self-employment, startups, innovation, risk-taking, equilibration . . . ?
- Making sense of the entrepreneurship literature: occupational, structural, and functional perspectives

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

- Occupational concepts
  - Entrepreneur = self-employed individual
  - Labor economics literature on occupational choice
  - Psychological studies of the entrepreneur’s characteristics
- Structural concepts
  - Unit of analysis: the firm or industry
  - Entrepreneurial firm = new or small firm
  - IO literature on industry evolution (Acs, Audretsch, etc.)
- Functional concepts
  - Alertness or discovery (Kirzner)
  - Judgment (Cantillon, Knight, Mises, Casson, Foss and Klein)
  - Innovation (Schumpeter), adaptation (Schultz), leadership (Witt)
  - Little relationship to occupational and structural approaches

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## The opportunity-discovery approach

- Dominant functional approach in management: opportunity discovery
- Theoretical and conceptual issues
  - Objective or subjective opportunities
  - Opportunities as black boxes
  - The unit of analysis
- Applications
  - Opportunities and organizational form
  - Opportunities and entrepreneurial teams

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## Objective or subjective opportunities

- Influence of Kirzner's (1973) metaphor of the "pure entrepreneur," costlessly discovering exogeneous, objective, profit opportunities
- Knight's (1921) subjectivist, uncertainty theory of profit
- Subjectivism implies that opportunities are neither "discovered" nor "created" (Alvarez and Barney, 2007), but perceived.
- Austrian capital theory and the essential subjectivism of resource attributes, and hence, profit opportunities (Menger 1871, Lachmann 1956, Kirzner 1966, Foss, Foss, Klein, and Klein, 2007)

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## Opportunities as a black box

- The Forrest Gump approach
- Analogy with preferences in neoclassical economics
- Classic economic accounts of the entrepreneurial function
  - Knightian judgment – that which generates profit under uncertainty (could be luck – depends on selection mechanism)

  - Kirznerian alertness – that which causes markets to equilibrate, and nothing more
  - Schumpeterian innovation – that which establishes new combinations (caveats)

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## The unit of analysis

- If opportunities are (a) subjective and (b) a black box, then the unit of analysis shouldn't be the opportunity or problem, but some action
  - Analogy with preferences, again
  - Casson's notion of projects (Casson, 2007; Casson and Wadeson, 2007) – a stock of resources committed to particular activities (opportunities are potential, but inactive, projects)
- Implies emphasis on opportunity exploitation, not identification
  - More generally, the execution of business plans
  - Specifically: assembly of heterogeneous resources under Knightian uncertainty (Lachmann, 1956)

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## Entrepreneurship and capital heterogeneity

We are living in a world of unexpected change; hence capital combinations . . . will be ever changing, will be dissolved and reformed. In this activity, we find the real function of the entrepreneur (Lachmann, 1956).

See also Foss, Foss, Klein, and Klein, "The Entrepreneurial Organization of Heterogeneous Capital," JMS 2007

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## Application I: opportunities and organizational form

- Attempts to encourage opportunity discovery do not necessarily foster opportunity exploitation.
  - Efficiency requires that entrepreneurs (and what Foss, Foss, and Klein 2007 call "proxy-entrepreneurs") bear the full wealth effects of their actions.
  - Inside the firm: promoting experimentation, creativity, etc. encourages moral hazard unless rewards and punishments are symmetric.
  - Outside the firm: strong IP regime, SBIR programs, etc. may encourage overspending on discovery.
- Organizing for opportunity exploitation
  - Staged finance
  - Returns to M&A and equilibrium takeovers

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## Application II: entrepreneurial teams

- Perception of a (subjectively identified) opportunity is an individual act, but exploitation of opportunities can be a team or group activity.
  - Syndicated venture capital, private equity, loans
  - Partnerships (professional services firms, closed-membership cooperatives)
  - Entrepreneurial networks (Parker, 2007)
- Sharing perceived opportunities
  - Penrose and the management team as a bundle of heterogeneous human resources (Foss, Klein, Kor, and Mahoney, 2007)
  - Convincing others to invest
- Organizational costs of collective action (Olson, Hansmann)

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## Application II: entrepreneurial teams (cont.)

- Evidence from "new generation" cooperatives in Renville, Minn. (Chambers, Cook, and Klein, 2005; Chambers, 2007)
  - Creation of a new organizational form
  - Role of the project champion(s)
  - Social networks, shared experience, and the willingness to invest
  - Path dependence and the stickiness of shared mental models (difficulty of conversion to LLC)

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## Takeaways

- What is an opportunity – do we care?
- Entrepreneurship literature needs more emphasis on
  - Deeds, not words or dreams
    - Counter-example: behavioral economics, neuro-economics, etc.?
  - Resources (heterogeneous and subjectively perceived)
    - Rothbard, 1986: "Entrepreneurial ideas without money are mere parlor games until the money is obtained and committed to the projects."
  - Organization
    - Opportunity exploitation is the name of the game

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