

interesting hypotheses about the Soviet economy being a rent seeking rather than a planned economy—that can eventually be tested against real-world Soviet data as they emerge. The application of modern political economy to explain the problems of transition has brought together the “old” and “new” economic specialists on the former Soviet Union. I am particularly pleased that Boettke, unlike others, has taken the time to examine the Soviet past and in particular question the stereotypes of the Soviet administrative-command economy that Soviet specialists have been too willing to accept.

**Paul R. Gregory**  
Professor of Economics  
University of Houston  
Pgregory@uh.edu.

*The Origin and Evolution of New Businesses* by Amar V. Bhidé.

Professor Amar V. Bhidé’s book, *The Origin and Evolution of New Businesses*, is a breath of fresh air in today’s world of economics. Perhaps because it doesn’t pretend to be a book on the economics of the firm, but rather a systematic, multi-disciplinary research on the subject of entrepreneurship and the emergence and evolution of businesses. It should appeal to Austrian economists and others who don’t find that mainstream firm theory adequately explains the emergence and growth of organizations.

Bhidé’s book is about understanding why and how distinctive firm capabilities emerge. It is about the emergence of organizations in an open-ended environment. It relates to entrepreneurs, their necessary skills and psychological qualities, the market environment in which businesses emerge and grow (e.g. availability of capital, business opportunities) and the critical strategies that entrepreneurs usually adopt to turn a business into a long-lived corporation. To a large extent, Bhidé shares this research program with many market process theorists such as Nicolai Foss, Stavros Ioannides, Peter Klein, Richard Langlois, Peter Lewin and the present author.

The book is divided into three sections. The first two treat the nature of start-ups and the evolution of businesses and the last one deals with economics and with policy issues that can be inferred from the first two chapters.<sup>1</sup>

### **Methodological Issues**

Some economists might be put off by Bhidé’s methodology: he bases his work mostly on case studies realized by his Harvard students and himself, as well as insights from the modern theory of the firm and industrial organization. He could of course fall into the tendency to try to induce general statements from empirical cases (however numerous they are), but I do not think he does.

In some ways, Bhidé’s approach is akin to comparative institutional/historical analysis, which some economists, such as Douglas North and Mancur Olson, have used to explain economic growth. Bhidé claims that minute and detailed studies of real firms may help

shed new light on problems such as decision-making and contracting under uncertainty. I don't see any problem with this approach as long as Bhidé doesn't fall into some kind of old-institutional analysis. Bhidé neither presents a pure economic theory of business firms nor a book on management. Also, he does not try to make normative claims about the development of organizations.

In fact, one can ask if economics lacks any depth to be of any use to scholars such as Bhidé. As Bhidé puts it himself: "The limitations of the modern 'theory of the firm' provide an important example of the usefulness of a broader perspective . . . With some exceptions . . . the literature has little to say about the problem of organizing joint effort. The theory focuses more on bilateral prisoner's dilemma games between 'principals' and 'agents' than on multilateral cooperation." (p. 367) Bhidé views a lot of what economics has to say as a deterministic exercise in which exogenous variables, production functions and preferences dictate the shape of organizations and markets. Sounds familiar?

### **So What about Austrian Economics?**

"My emphasis on the entrepreneurial factor is to redress its prior neglect," writes Bhidé (p. 209). Any Austrian economist reading these words is filled with joy! Unfortunately Bhidé does not seem to be very familiar with market process economics and the work of modern Austrian theorists in the field of organizations. This is a weakness of the book that frustrates the reader who is knowledgeable of this area. In fact, Bhidé pays lip service to Austrian economics. Entrepreneurship is at the center of his work, but there are only a few direct references to the Austrian view.

This frustration results in part from the use of the term "entrepreneur." Many Austrian economists, such as Israel Kirzner, use the term to refer to the function of entrepreneurship, that is arbitrage, which can be found in any individual in the market. For Kirzner the essence of entrepreneurship revolves around the concept of alertness: entrepreneurship is not a factor. In that sense, the entrepreneur is not an ideal-type like the capitalist or the worker. Another way of using the term "entrepreneur" is to refer to a specific type: the entrepreneur is the one who starts a business. Like many, Bhidé most of the time refers to the entrepreneur in this sense. True, in the real world the entrepreneur may often hire her own labor as a manager and coordinator of assets. While this is very important to studies such as Bhidé's, it is not important to the understanding of the essence of entrepreneurship. Thus Bhidé does not use the term in the sense many Austrians would use it.<sup>2</sup>

This being said, Bhidé acknowledges the Austrian point of view in a section on "The 'Disappearance' of the Entrepreneur" (pp. 6–7), and even more importantly, he explicitly recognizes the empirical meaningfulness of the Kirznerian entrepreneur (pp. 88–89 and 194). As Bhidé puts it: "[E]conomists have described the role of an entrepreneur . . . in a variety of ways: innovation (Schumpeter), coordination and combination of other factors of production (Say), risk-bearing (Cantillon), responsibility for uncertainty (Knight) and arbitrage (Kirzner) . . . Their [Entrepreneurs'] activities (in the start-up stage) seem to correspond more closely to the role of arbitrageur; . . . they often take advantage of information gaps to buy cheap and sell dear. And to the extent that they combine multiple inputs . . . we

can attribute the role of coordinator to them as well.” (pp. 88–89) As one can see, Bhidé emphasizes arbitrage and coordination: it would be difficult to find more Austrian concepts in economics.

In some ways and because many parts of the book are Austrian in their flavor, one could say that Bhidé is like Monsieur Jourdain in Molière’s *The Bourgeois Gentleman*: he thinks along the lines of market process theorists but without knowing it. Of course Bhidé’s knowledge of Austrian economics is undoubtedly incomplete and this frustrates the Austrian reader at times. The failure to rigorously use Austrian theory is unfortunate because Austrian economics should appeal to firm theorists such as Bhidé. But the blame is not to be put on these researchers, but on market process economists who have not yet marketed their ideas well enough.

For instance, Bhidé sometimes misunderstands the role of market disequilibrium (e.g. see pp. 323–324), and he does not refer to Hayek’s work when this could add to his analysis (e.g. see p. 240). Another instance is his section on prior experience which is very interesting (pp. 31–37), but there is, unfortunately, no reference to Scott Shane’s Austrian-inspired work. The chapter entitled “Reexamining Schumpeter” (pp. 319–337) shows how much Bhidé is well versed in the Schumpeterian theory of “creative destruction” as it is generally accepted (even by some mainstream economists). But a deeper knowledge of some Austrian criticisms of Schumpeter’s views (and I think here of Kirzner’s and Rothbard’s critiques for instance) would strengthen Bhidé’s assessment.

However, Bhidé’s emphasis of the strong limitations of the modern theory of the firm, especially his case for the importance of radical uncertainty (pp. 365–366) in actual decision-making, shows how much market process analysis is “natural” to scholars such as Bhidé. Also, most Austrian economists should be comfortable with Bhidé’s very good assessment of modern industrial organization theory (pp. 306–313), his analysis of stochastic innovation in economic models (pp. 243–244) and more generally his criticism of the absence of purposeful action and entrepreneurship in the literature on firms and evolutionary processes (pp. 238–259). Finally, Bhidé’s claims that (a) the structures of industries are largely shaped by entrepreneurial activity and (b) arguments about economies of scale in themselves are not enough to explain industrial patterns, are very appealing and deserve attention especially with regard to the old debate on monopoly (pp. 290–315).

### **The Emergence and Growth of Businesses**

Despite the lack of direct references to Austrian economics, the book has much to offer regarding the understanding of the emergence and growth of businesses.

Austrians won’t be surprised to learn that Bhidé sees entrepreneurship and the coordination of assets as core issues in the explanation of the growth of businesses. While the coordination of assets is not a critical task in the early stages of a firm, as a firm grows, asset coordination becomes more and more important<sup>3</sup> (e.g. chapter 11 on coordination and strategy). While I am in agreement with Bhidé on the importance of coordination, I would add that there is also a social coordinative role that firms play in the market and this is of interest to Austrian economists. In this sense, any organization (small and big alike) plays

a coordinative role in the market system and this may explain the existence of order rather than chaos in the marketplace (see Sautet 2000:78–79).

Bhidé often gives the impression that the entrepreneurial problem of the small company is very different from that of the corporation. In many ways, the problems are different, especially in the type of opportunities that are exploited, as Bhidé explains very well. However, I would argue that the discovery problem is fundamentally the same in both cases. As Schumpeter put it: “In the large-scale corporation of today, the question that is never quite absent arises with vengeance, namely, who should be considered as the entrepreneur.” (Schumpeter 1947:226) In that sense, I would not make as strong a distinction between small companies and established corporations as Bhidé does: both may make arbitrages and correct earlier errors made in the course of market exchange (p. 194).

Another subject of the book that may interest Austrians regards the specifics of the entrepreneurial profile. Bhidé’s work is very informative in this matter. Kirzner has emphasized at times (especially at the NYU Austrian Economics Colloquium) the need for Austrian economists to explore psychological and sociological approaches to entrepreneurship that may reveal general human traits that one can observe (or expect) in entrepreneurs. Most Austrian economists (as well as Kirzner himself of course) know that this may be a difficult task. However, it seems that Bhidé provides a few interesting insights, even if they are far from being complete (if only because Bhidé regards entrepreneurship in too narrow a way).<sup>4</sup>

In substance, Bhidé explains that individuals with some college education who have a middle class background are the most likely to start a business simply because they have the best combination of intelligence and low opportunity cost. Also, decisiveness, open-mindedness, attribution and sales skills, tactical ingenuity, self-control and perceptiveness are essential traits of individuals starting businesses (pp. 99–109). This list makes sense and there isn’t anything controversial in it. What is more interesting is the emphasis on another trait: “tolerance for ambiguity”. As Bhidé explains (p. 96), ambiguity is close to Knightian uncertainty, but is not quite the same. True radical uncertainty involves ignorance of one’s own ignorance. Ambiguity relates more to the absence of any known probability to the decision maker even if she has some idea about the existence of some risk. Bhidé claims that tolerance for a state of affairs where the future is mostly unknown is crucial to entrepreneurial behavior. Moreover, some individuals may like taking risks while being averse to ambiguity (and vice-versa).

Bhidé also argues that the traits required to build large and long-lived firms are different from those needed to start a business (pp. 260–315). In fact, Bhidé argues that there are two distinct types of individual entrepreneur who may succeed at different stages the development of a business. Rarely one meets an individual who has the skills, the ambition and the alertness (as Austrians would say) to start a business from scratch and to turn it into a billion-dollar company.

Austrian economists and others have explored the influence of the institutional structure on individual behavior. I would even argue that this subject might become increasingly important in the future. Bhidé seems to downplay the importance of firm structures in the way knowledge is generated (e.g. Foss) and entrepreneurial behavior takes place. For instance, there is a lot to be said about the way the M-form may foster entrepreneurial behavior within firms (e.g. Sautet).

### **Policy Implications**

In the last part of the book, Bhidé explains that there isn't much that governments can do to help the emergence and growth of businesses. "Public policies cannot easily influence the climate for the formation and growth of promising businesses" (p. 359). In other words, governments cannot pick winners and the potential for positive government policies for growth (of businesses) is limited.

Moreover, the majority of start-ups are self-financed. In fact, the success of many start-ups depends precisely on the scarcity of the available capital. Indeed, Bhidé argues that the lack of available capital arouses entrepreneurial ingenuity. Also, the role of venture capital is very limited for two reasons: (a) venture capitalists do not generally intervene in the first years of development of a business but rather when the business has somewhat matured and (b) it represents only a minority of all funding. Thus those who claim that the lack of entrepreneurship stems from the lack of venture capital are wrong. On the contrary, because the marginal returns of venture capital funds are not higher than that of any other activity (risk-adjusted), the amount of venture capital is likely to be correct: there is no market failure (see the excellent chapter on venture capital pp. 141–165).

Also, if Bhidé is correct in his assessment of the socio-economic background of entrepreneurs, then it is not clear whether public investment in education could change the level of entrepreneurship. In fact, one could argue that public education would not generate more entrepreneurs because: (a) public education at the high-school level does not necessarily teach the knowledge and skills that could help kids start their own business and (b) publicly financed tertiary education may influence the number of lawyers, medical doctors and economists but not necessarily the level of entrepreneurship. Moreover, if one accepts the proposition that real economic growth is related to entrepreneurship then one could argue that modern views on growth, such as endogenous growth theories, are misleading: more public investment in education may not lead to the development of more businesses and more economic growth.

### **Conclusion**

Amar Bhidé's book deserves much attention. True, it is not a book about the economics of the firm and this may turn some economists away from it. But I would argue that we must open our ears to academics who argue that firms are created by entrepreneurs and that entrepreneurs also shape the conditions of markets. The fundamental message of Bhidé's book is that there is nothing mechanistic in the emergence and growth of businesses. I view this result as a signal that market process theorists are right in the way they understand the world. The future lies in more cooperation with scholars such as Bhidé so that economics understood as a multi-disciplinary research program progresses ever more.

### **Notes**

1. The page references in parentheses in the text refer to *The Origin and Evolution of New Businesses* unless otherwise specified.

2. Ludwig von Mises explicitly refers to the “entrepreneur-promoter” as the market pacemaker, which encompasses those who start businesses (see Mises 1966:255). Thus the notion of the entrepreneur is broader in the work of Mises (and of Kirzner) than in that of Bhidé.
3. This relates directly to what the present author explains in his work on the emergence of firms and the necessity to coordinate assets over time in order to capture an identified profit opportunity (see Sautet).
4. Bhidé also points out that studies that have tried to establish a psychological profile of the entrepreneur have not been conclusive (pp. 92–93).

## References

- Bhidé, Amar V. (1999) *The Origin and Evolution of New Businesses*. Oxford: Oxford University Press.
- Foss, Nicolai (1999) “The Use of Knowledge in Firms.” *Journal of Institutional and Theoretical Economics*, 155(3): 458–486.
- Kirzner, Israel (1973) *Competition and Entrepreneurship*. Chicago: University of Chicago Press.
- Kirzner, Israel (2000) *The Driving Force of the Market*. London: Routledge.
- Klein, Peter (1996) “Economic Calculation and the Limits of Organization.” *The Review of Austrian Economics*, 9(2): 3–28.
- Klein, Peter (1999) “Entrepreneurship and Corporate Governance.” *The Quarterly Journal of Austrian Economics*, 2(2): 19–42.
- Langlois, Richard and Robertson, Paul (1995) *Firms, Markets and Economic Change*. London: Routledge.
- Lewin, Peter (1999) *Capital in Disequilibrium*. London: Routledge.
- Mises, Ludwig von (1966) *Human Action: A Treatise on Economics*. Chicago: Henry Regnery.
- Rothbard, Murray (1987) “Breaking Out of the Walrasian Box: Schumpeter and Hansen.” *The Review of Austrian Economics*, (1): 97–108.
- Sautet, Frederic (2000) *An Entrepreneurial Theory of the Firm*. London: Routledge.
- Schumpeter, Joseph (1947) “The Creative Response in Economic History.” Reprinted in *Essays on Entrepreneurs, Innovations, Business Cycles and the Evolution of Capitalism*. Clemence, Richard, V. (ed.) (1989) pp. 221–231. New Brunswick, USA: Transaction Publishers.
- Shane, Scott (2000) “Prior Knowledge and the Discovery of Entrepreneurial Opportunities.” *Organization Science*, 11(4): 448–469.

**Frédéric Sautet**  
Senior Analyst at the New Zealand Treasury.