

# **Entrepreneurship as a point of departure for a course in pluralist economic principles**

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by

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## **Abstract**

Many commentators have pointed towards a downturn in the enrolment of students on economics degrees. Part of the explanation for this phenomenon is probably because business studies degrees meet students' requirements for practical understanding more closely. We suggest here that one of the problems with economics is that introductory principles courses adopt a 'theory-first' pedagogy. This means that students are asked to abandon any pre-formed notions/understanding about the nature of competition and accept the equilibrium model of perfect competition as the foundation of their future understanding. The downside of this approach is that: 'The everyday appearance of social life provides little in the way of verification for the student of basic economic ideas. The result is an analytical confusion that captivates the student more or less forever...' Bernstein (2004: 33). By grounding introductory economics on the foundation stone of theories of entrepreneurship this problem is circumvented. Our discussion here suggests how entrepreneurship could be introduced to students and how it can lead to a deeper understanding of the true nature of the competitive process. The approach we advocate is pluralist.

Keywords: entrepreneurship, insufficiency of knowledge, inductive teaching, case study, competitive process, evolution.

JEL codes: M13; A22; B40; B52; B53; D01; D02; D20; D80

## Introduction

We begin with some broad observations:

- (1) Many commentators have pointed towards a downturn in the enrolment of students on economics degrees (e.g. papers in a special issue of the *Journal of Economic Education*, volume 27, Fall 1996; Lewis and Norris, 1997; Ashworth and Evans, 2001). Part of the explanation for this phenomenon is probably that business studies/business administration degrees meet more closely students' requirements for practical understanding.
- (2) The economics profession has turned inwards to impress peers and has increasingly ignored 'troublesome' aspects of the real world and disengaged with public discourse (Klein, 1999).
- (3) The student-driven Post-Autistic Economics movement has arisen because of mass dissatisfaction with 'unrealistic' single-paradigm economics.
- (4) It is widely accepted that entrepreneurship is a fundamental driving force of economic progress in the real world and its study attracts great interest from economics and business students alike (witness the growth of courses in entrepreneurship and the emphases of governments in both developed and less developed countries on developing an 'enterprise economy'.)

If observations (1) and (2) are correct the profession should be worried and looking for ways to repopulate itself. Among others, Geoff Hodgson has stated that

Outside, in the business, government and other non-academic communities, the perception is widespread and growing of economics as a technical and rarefied discipline, of questionable relevance and limited practical use. This widespread opinion is manifest in declining student enrolments on economics degree courses and in a shift towards close substitutes such as business studies. (Hodgson, 1999: 9).

If economics degrees are losing out to close substitutes and if the profession cares about this loss of 'customers' for its standardised product then the obvious solution would seem to be to reinvent the economics we teach at grass roots level (i.e. introductory undergraduate level) so that it more closely reflects the needs of the real world. After all, the demand for undergraduate courses is a derived demand driven by the requirements of employers (in both the private and public sectors) who want recruits who can understand real world practicalities.

Observation (3) suggests that it is not too late to save economics from obscurity; the young blood is waiting in the wings and mass-movements like the PAE indicate that the customer base is still substantial if only the profession will listen and broaden its scope. This is, of course, what the movement towards pluralist economics advocates. Observation (4) suggests that the growing emphasis on entrepreneurship as a fundamental economic force and the desire

of students to learn a more relevant economics can be combined to reinvigorate economic theory.

It seems clear that many champions of a pluralist approach to economics reside in academia but the question of how to replace orthodox theory has largely focussed on post-first-year economics. This seems to reflect an attitude that first-year principles courses are more or less fine in their current format because they provide a useful foil against which to introduce heterodox economics at a later stage. At first glance this seems to be a reasonable teaching strategy, but it raises the problem that students may become socialised into mainstream economics and regard the later introduction of heterodox economics as mere tinkering. It also means that perfect competition and equilibrium form the foundation of the student's understanding of the economy and may colour all future understanding and prove hard to shift; in fact, a process of 'unlearning' is likely to be needed. As Bernstein (2004) has argued: 'The everyday appearance of social life provides little in the way of verification for the student of basic economic ideas. The result is an analytical confusion that captivates the student more or less forever...' (p.33), and: 'Ironically, the perfect competition model suffers not from being an abstraction from reality – indeed all models in all disciplines share that epistemological quality. Rather, the pitfall of utilizing the perfect competition framework as a starting point for economic reasoning is that it makes a logically coherent understanding of what competition is impossible' (p.34). It is our contention here that taking entrepreneurship as the departure point for an introductory principles course overcomes these kinds of difficulties and at the same time should make economics a more attractive option relative to its close substitutes.

In the next section we outline the basic principles that a pluralist/heterodox course should attempt to reveal to students. We follow this with a brief overview of three major economic theories of entrepreneurship before going on to the final section where we suggest a teaching strategy for conveying these theories to students. It is not our intention to outline what 'Pluralist Economics 101' should look like in its entirety, since this is a destination for the wider pluralist community to arrive at through discussion and debate, but we do indicate how using entrepreneurship as a point of departure can lead seamlessly into wider discussions about the true nature of competition.

## **The Basic Principles of Pluralist Economics**

In this section we outline the lessons that a pluralist course in economics should aim to convey as a *minimum requirement*. These lessons can be thought of as a destination for students so it is neither strictly necessary nor necessarily desirable to be explicit at the outset about them in a teaching environment. This is because there is a pedagogical argument that students should discover the lessons for themselves since then they are more likely to understand their significance (and remember them).

It is traditional to begin a course in economics with a definition of its scope and boundaries, and from a pluralist perspective it is important to work with a definition that does not circumscribe the discipline too rigidly. From this standpoint, the familiar Robbins/Samuelson definition will not do. In contrast, Alfred Marshall's definition from his *Principles* seems to fit the bill nicely:

Political Economy or Economics is a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of wellbeing. (Marshall, 1920: 1)

Marshall's definition is useful for pluralist economics to adopt because it is specific enough to indicate the general area of study and at the same time broad enough to leave its boundaries relatively permeable to a variety of approaches and ideas. We use Marshall's definition here to emphasise three fundamental points:

(1) *Economics is about 'mankind', which we can interpret to mean real people.* Consequently economics should take account of the challenges faced by real people with respect to what George Shackle (1972) called their 'insufficiency of knowledge.' As we all know, Friedman (1953) argued that the usefulness of an economic model lies in its predictive ability and hence took a methodological position that it was all right for economists to think about human beings *as if* they are fully informed and fully rational optimising automatons so long as such an approximation to reality predicted well. For a long time mainstream diehards (particularly the 'mathematical formalists') have taken shelter from criticism by ducking behind the barrier of Friedman's argument as if it were an inviolable truth, whilst producing models that were either short on predictive content or of questionable empirical validity (such as expected utility theory). This does nothing to enhance the credibility of economics in the wider academy: as McCloskey (1999: 117) notes, the 'neighbours of economics hate its arrogance.'

The nature of the problem is exemplified by the following vignette:

[As an undergraduate student in economics] I had done well in my studies and my department chairman said to me: "It's time to start getting those applications in to graduate school." I looked at him rather astonished, and said, "You don't think I'm going to graduate school do you?" And he said, "Well, of course – you got all As." I replied "I'm *interested* in economics, I can *do* it, but I don't *believe* it." (Michael Rothschild, 2000: 285)<sup>1</sup>

Shackle (1972: 15) points out that the architects of mainstream economics chose to ignore 'the question of what can be known by the maker of choices amongst rival available courses of action, and concentrated instead on the *logic of comparison* amongst courses having assumedly known results.' He asks us to

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<sup>1</sup> Rothschild chose to go on to business school and law school and later became a consultant.

take a step backwards and inquire how possible courses of action can be identified in the first place and in so doing points us towards an economics in which the imagination of possible futures and courses of action must play a central role. In other words an economics where human creativity is taken seriously.

Brian Loasby (1999: 2-7) identifies six obstacles to knowledge in arguing the case for basing economics upon explicit recognition that the insufficiency of knowledge is pervasive. These can be summarized (without necessarily using his labels) as follows:

(i) *David Hume's problem*: the impossibility of obtaining certain knowledge/universal laws. We cannot obtain reliable knowledge about the world because it is impossible to observe every occurrence of a phenomenon and as a result we cannot say for sure that evidence does not exist which refutes the generality of the laws based upon observations derived from a sample. Hume's problem is especially acute when we recognise that we cannot possibly know the future with any certainty; in essence all expectations that we form about the future are conjectural in the sense that they cannot be based on reliable evidence.

(ii) *The inherent complexity of the world*: if the world is a complex open system as, for example, Potts (2000) has argued, then it is impossible for us to understand it in its entirety. Complex systems are, '...systems with multiple elements adapting or reacting to the pattern these elements create...complex systems are systems in process, systems that constantly evolve...The patterns that are in the process of being formed are too complicated to be worked out analytically...' (Arthur, 2000: 19). Furthermore, in order to build theories it is necessary to make simplifying assumptions to keep things manageable (i.e. achieve artificial closure) and this renders the theory incomplete and the reason for any failure of its predictions impossible to pin down: 'An open system is one whose boundaries are not predetermined. Further, the nature and range of its constituent variables and the structure of their interrelationships are not predetermined...If reality is an open system, then any closed theoretical system can only have partial application' (Sheila Dow, 1997: 89-90).

(iii) *Bounded rationality*: Herbert Simon's (1957) contention that human decision makers would like to act rationally, in the sense of the rational economic model, but are prevented from doing so by the cognitive limitations of the human brain combined with the overwhelming informational requirements (including problems of both information overload regarding possible options and those caused by the need to have unknowable information about the future) is well known to heterodox economists. As Bazerman (2002: 4) has stated, 'The

rational model is based on a set of assumptions that prescribe how a decision *should* be made rather than describing how a decision *is* made.' Earl (1995) has drawn attention to the implications of cognitive facts of life such as Miller's Rule, while Hallowell (2005) has analysed the resulting problem of 'overloaded mental circuits'. In order to overcome their cognitive limitations decision makers in real life use rules of thumb (heuristics) to guide decisions and they satisfice rather than optimise.

(iv) *The ubiquity of change*: the analysis of change was central to Schumpeter's interpretation and analysis of the economy and in contemporary economics it is explained by evolutionary economists such as Nelson and Winter (1982). For evolutionary economists change is a given feature of systems in the real world. This follows from the 'Red Queen Principle' (Van Valen, 1973) which can be illustrated by the following simple example: If two firms share the same market and one develops a new product that places the other at a competitive disadvantage, then the desire to regain market share will require the other firm to strive to introduce a new product too. This will, in turn, lead to further pressure coming to bear on the first firm and the cycle will continue. The important point to note here is that change is endogenous to the system and, while we may recognise this to be the case, its specific form is unpredictable with any degree of certainty.

(v) *Richardson's competitive investment problem*: George Richardson (1960/1990) pointed out that the realisation of a profit opportunity for a particular firm depends in part on the price the product is expected to command. He asked, 'how the members of a system could obtain sufficient information on which to base investment decisions' (p49). The basic problem here is that price will be influenced by the plans of other firms who may also have recognised the profit opportunity. These plans will be hidden from each other *a priori* and, consequently, there will be a coordination problem that may be so severe that if all firms tried to exploit the profit opportunity none of them would receive the expected return on their investment. In other words all of the potential competitors face the same puzzle and there is no totally reliable or simple way to coordinate their activities. For firms to be willing to enter a market or expand capacity, they will need to have confidence about the limited ability of others to do likewise.

(vi) *Richardson's complementary investment problem*: Richardson also identified that interdependencies do not only exist in firms' competitive relations with each other. It is also the case that the rewards of a proposed action by one independent decision maker may well be contingent upon the expectations and plans of one or more other independent decision makers in such a way that their

relationships are complementary in the sense that ‘...the costs of one are reduced when the other is undertaken, or because the demand for one of them rises with the increased availability of the output of the other.’ (p.78) Furthermore, ‘it is possible for two or more firms to be in a complementary relationship without there being transactions between them’ (p.73). An example of this would be if a firm supplying several other downstream firms were able to exploit increasing returns (and thereby sell on at lower prices) if all firms involved invested simultaneously.

(2) *Economics is not about isolated individuals; it is about ‘social action.’*

Economics is a social science, so while it is important for economic theory to recognise the limits to human knowledge it is also important to recognise that economic decisions do not take place in an institutional vacuum (Thorstein Veblen, 1899; Hodgson, 1988). Institutions are conventions, routines and procedures that evolve in response to problems caused by the insufficiency of knowledge (e.g. uncertainty) that face interacting individuals (Loasby, 1999). While mainstream economics takes individual preferences as given and uninfluenced by external forces, the view of institutional economics is that individuals are embedded in a social and institutional culture and that they are influenced by this environment. Hodgson gives the example of trust to illustrate the importance of the concept of the socially embedded individual:

Trust is an interpersonal relationship of some economic significance. Trust is an emergent property of an enduring and reciprocal relationship between multiple individuals in an institutional context. It is a relational property; not something that is the property of isolated individuals. Accordingly, the environment of trust, or lack of it, affects individual aims and preferences. (Hodgson, 2002: xxii).

If individuals are socially and institutionally embedded this means that we need to understand the impact of their environment to fully understand their behaviour. Given that social systems differ both with geographical location and over time this means that a general theory of the individual as proposed by mainstream economics is impossible to identify. However, Hodgson (2002) also warns that it does not mean individuals are influenced solely by institutions any more than it implies acceptance of the doctrine that institutions can be explained by the ‘preferences and purposes of individuals alone.’ Instead, he advocates following Veblen’s original non-reductionist approach, which does not try to explain one level of analysis (e.g. the individual) entirely in terms of another level of analysis (e.g. institutions) but instead employs a multi-level, co-evolutionary approach.

In short, then, individuals who suffer from problems of knowledge are embedded in complex social/institutional webs (which evolve as time passes and which differ across geographical locations). Consequently, the economics we

teach should guide students towards these two 'realities' that face people as they go about the ordinary business of life.

(3) *Economics is about 'wellbeing'*.

This can be interpreted as meaning the wellbeing of society as a whole or the wellbeing of an individual. Its identification and achievement may be rendered problematic by the insufficiency of knowledge of both the economic theorists who study it and the subjects of their studies. So, economic analysis necessarily requires the economic theorist to offer value judgements and this means that she or he will have to apply critical thinking skills and become a practitioner of rhetoric (McCloskey, 1985, 1994).

### **Economic Theories of Entrepreneurship**

In their content analysis of the coverage of entrepreneurship in 14 major introductory textbooks Calvin Kent & Francis Rushing (1999: 184) report that 'it appears that entrepreneurship still has not worked its way into economics principles texts. As a result, students may be left with an incomplete understanding of the economic process.' This is hardly a surprising finding – principles texts are almost exclusively mainstream in their outlook and a meaningful discussion of entrepreneurship cannot simply be bolted-on to a framework that has been designed to ignore the phenomena of insufficiency of knowledge and the process of change. For example, consider the decision to start a firm. In the real world this is a task that is riddled with uncertainty, but the mainstream perspective ignores the insufficiency of knowledge that gives rise to the uncertainty. In fact, the entrepreneur in the mainstream theory of the firm is assumed to have full (*ex ante*) knowledge about: the availability of factor inputs; the quality of factor inputs; the variety of ways in which factor inputs can be combined; and buyers' demand for the firm's product. This means that the practical questions that would face and challenge a real world entrepreneur are absent and the entrepreneur's choices are automatic.

Two things in particular are glossed over by the mainstream theory of the firm. The first is the question of how the business opportunity that led to the founding of the firm emerged in the first place; here the assumption is that business opportunities will be automatically recognised and acted upon. The second is how the entrepreneur decides on the best way to obtain, organise and utilise the inputs and productive resources under her or his control. The assumption here is that if two entrepreneurs had access to the same quantity and quality of inputs and factor services, then we could expect both to utilise and organise these assets in an identical way within their respective firms. In other words, the rival firms would not only be as efficient as each other, but each firm would be expected to operate at optimum efficiency. The implications of these assumptions for our understanding of the nature of competition are well known and exemplified by the theory of perfect competition. However, even with the more realistic-looking theory of monopolistic competition, from which emerged



the '4Ps of marketing' (competition via not merely price but also place, product and promotion), textbook treatments ignore the knowledge issues that Chamberlin (1933) wrestled with in his original exposition and which lead real businesses to choose different marketing mixes.

As Stan Metcalfe (2004: 157) says, 'Economic theory and the entrepreneur have never made easy travelling companions,' and he concludes that this is because of the treatment of knowledge. Entrepreneurship is about creating new knowledge and ushering in change of one sort or another, it is about choosing to make resource commitments in the present in the face of an uncertain future in the sense of Frank Knight (1921). Hence it necessarily deals with questions that are beyond the scope of rational choice theory and that implies that any serious treatment lies firmly in the domain of heterodox economics.

Several serious theories of entrepreneurship have been proposed in the literature and each one has something useful to contribute to a more complete understanding of the economic role of entrepreneurship. Here we provide a brief overview of three major contributions. Each theory offers its own definition of entrepreneurship and in so doing tries to bring precision to the topic at the cost of apparently excluding the definitions offered by alternative theories. To the extent that alternative theories provide useful insights there would appear to be a need for synthesis here. We comment on this in the final section.

#### ***(i) Schumpeter on the entrepreneur as innovator***

Schumpeter (1934, 1942) is very clear about the role of entrepreneurs in society. In essence they are the primary agents of economic development and change and they think up ways of putting scarce resources to new uses. They do this by carrying out one or more of five broad activities:

- introducing new goods or a new quality of good;
- introducing new ways of producing goods;
- opening up new markets (usually overseas);
- discovering new sources of supply of raw materials or partly-manufactured goods; and
- reorganising the structure of an industry (for example, by creating a monopoly or breaking up a monopoly situation).

Each of these activities is an example of innovation.

Schumpeter is very precise about the meaning of innovation, in particular he is very careful to distinguish between invention and imitation. Invention is an activity which can be thought of as more in the realm of the creation of scientific knowledge than business, although this is not necessarily the case, and it provides a possible source of raw material upon which entrepreneurial individuals can draw as they seek out business opportunities (one might think of the scientific knowledge that underpins everyday commercial products such as the light bulb, the motor car, and the aeroplane). Innovation on the other hand refers to the very first commercial application of what up to that point has remained

non-commercialised knowledge and the first person to do this is called the entrepreneur.

Schumpeter points out that 'to produce means to combine materials and forces within our reach' and that the same materials may well be used in different ways. He describes these potential alternatives as new combinations and identifies the entrepreneur's role as the discovery and commercialisation of new combinations. The second person in the market is not an entrepreneur according to Schumpeter's definition because the first person has already shown the way. The second and subsequent entrants/adopters are simply imitators.

Schumpeter's discussion also points out that a particular person should only be described as an entrepreneur at the point when she or he first introduces their innovation. The subsequent activity of running and managing the resulting business is not entrepreneurship in Schumpeter's view – it is instead the more routine job of business administration. However, Schumpeter also points out that an entrepreneur does not necessarily have to be a business proprietor; it is quite plausible within his definition of entrepreneurship for a manager employed by a firm to carry out an entrepreneurial act and, in fact, given the prevalence of large corporations within the developed economies of the world this implies that continued business success may well depend upon the development of entrepreneurially inclined executives – in other words, intrapreneurship (see Meyer & Heppard, 2000).

Schumpeter draws a clear distinction between entrepreneurs and capitalists. Capitalists are the providers of finance; they lend money to entrepreneurs and as such Schumpeter is adamant that entrepreneurs do not bear the financial risks associated with their novel actions. This is a point of contention. The problem with Schumpeter's view on this point is that by definition the outcome of innovative activity is uncertain and it may be very difficult to persuade third parties to invest in unproven activities. Equally, the entrepreneur may be reluctant to reveal the innovative idea to a third party because this will open her up to a potential competitor (although the degree of tacit knowledge required to put the idea into operation may provide some protection here).

### ***(ii) Hayek and Kirzner on the entrepreneur as the source of equilibrium forces in competitive markets***

The various writings of Friedrich Hayek (e.g. 1948) and Israel Kirzner (e.g. 1979) are classed as major contributions to the Austrian tradition of economics. The Austrian analysis of the entrepreneur is intimately associated with the quest for a deeper understanding of the workings of the dynamics of markets *that already exist*.<sup>2</sup> Austrian economists take as their point of departure the notion that market equilibrium is the end result of the economic process and as such it is a relatively uninteresting phenomenon. The implication of their view is that economists ought to devote most of their time and energy to developing a deeper understanding of the disequilibrium processes that generate eventual equilibrium outcomes because it is only when a market is in disequilibrium that active decisions are

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<sup>2</sup> Austrian economics is far from unified. See Gloria-Palermo (1999) for an illuminating discussion of contrasting Austrian conceptions of the market process.

being taken by suppliers and demanders. The Austrian theory of the entrepreneur is developed in this disequilibrium context.

If a market is in equilibrium it implies that entrepreneurs and their customers have arrived at a state of the world where neither group has any incentive to change their trading behaviour. From an entrepreneur's perspective this means that no further profit opportunities remain to be exploited in the market.

Hayek describes the equilibrium state as one where everyone has full information about potential trading opportunities and where everyone has acted optimally in the light of this information. Disequilibrium behaviour is therefore exemplified firstly by the acquisition of useful knowledge and, secondly, by its communication. For example, an entrepreneur may have acquired some useful knowledge that enables her or him to obtain a particular good at a cost that is lower than is being achieved by rival entrepreneurs, but unless this fact is communicated to customers (in the form of lower asking prices) they are unlikely to switch their custom away from the low-cost entrepreneur's rivals. For Hayek the disequilibrium market process can usefully be described as a process of discovery. For example, the entrepreneur discovers whether asking prices and product quality are appropriate while customers discover who is able to supply them with goods of acceptable quality at prices that offer them value for money.

Kirzner picks up Hayek's theme and points out disequilibrium situations can arise because of interspatial (geographical) differences between suppliers and demanders which give rise to opportunities for arbitrage. According to Kirzner anyone who practises arbitrage is an entrepreneur. In fact the key characteristic of the entrepreneur for Kirzner is alertness to such potential sources of profit.

Another source of disequilibrium arises because of intertemporal differences between supply and demand. The entrepreneur who is alert to this situation undertakes to obtain or produce goods or services without knowing what the quantity demanded will be. The entrepreneur in this situation takes a truly heroic decision in the sense that she faces uncertainty rather than calculable risk.

The focus of Hayek and Kirzner is on explaining movements towards equilibrium in markets that already exist as a result of the actions of individuals who are alert to profit opportunities. It thus contrasts with Schumpeter's contention that the entrepreneur is an innovator and therefore a destroyer of equilibrium situations. Clearly there is scope to reconcile the two perspectives by broadening out Schumpeter's somewhat dogmatic insistence that entrepreneurship equates solely to innovation (cf. Kirzner, 1999).

### ***(iii) Casson on the entrepreneur as a specialist in coordination***

Mark Casson (1982/2003) formulated his theory of entrepreneurship as a step towards a more comprehensive project (Casson, 1997) in which he developed a 'vision of the economy as a system of structured information flow.' He begins with a critique of General Equilibrium theory and in particular its reliance upon the fictitious Walrasian auctioneer as the agent of coordination in the economy. In

the real economy buyers wants are coordinated with the outputs of suppliers without the aid of a Walrasian auctioneer. Casson investigates how coordination actually occurs and he places the entrepreneur at the heart of the process.

Casson (2003: 20) starts his detailed analysis with a very precise definition: 'an entrepreneur is someone who specializes in taking judgemental decisions about the coordination of scarce resources.' Three key points arise out of this definition.

The first point is that the entrepreneur is a specialist at what she or he does. From an economics perspective when somebody specialises in an activity they do so because they have a comparative advantage. The economic theory of comparative advantage implies that relative capabilities of individuals are fixed which means that this assumption requires us to ignore the effects of education, training and practice which will allow people to improve their capabilities as time passes. However, this observation does not pose a problem for Casson because he argues that the core capabilities (qualities) of the entrepreneur (which are the source of her or his comparative advantage) are very difficult or impossible to learn — in fact he argues that some of these capabilities are more or less innate. Furthermore, he suggests that these innate capabilities are unevenly distributed throughout the population and that they are scarce. From a list of decision-making qualities that includes self-knowledge, imagination, practical knowledge, analytical ability, search skill, foresight, computational skill, and communication skill, he constructs a hierarchy in which imagination and foresight are identified as being critical. Imagination is required in order to perceive of alternative ways in which resources can be utilised while foresight is a complement to imagination and entrepreneurs especially need it because there may well be a shortage of suitable data to collect as a result of the novelty of the alternatives conjured up at the imagination stage. Someone who possesses only one of these two qualities will not make a successful entrepreneur; ideally the entrepreneur should possess all of the qualities (i.e. be a generalist). However, Casson argues that the nature of the other qualities is such that they are perhaps less difficult to hire in than the two essential ones and it may therefore be possible to employ other people who possess the requisite 'missing' qualities. Because of difficulties with identifying these qualities in people, he does not suggest that this task is an easy one. Furthermore, if the 'hiring in' route is followed, it will be essential for the entrepreneur possess the two extra capabilities of delegation skills and organisational skills.

The second important point highlighted by Casson's definition is the judgemental nature of the decisions that the entrepreneur makes. Judgemental decisions are those for which the decision-maker does not have objective criteria to guide her or his choice. Judgemental decisions involve different perceptions of problems and issues, different interpretations and possibly access to different information. Typically an entrepreneur can be thought of as someone who judges situations and opportunities differently from the majority of other people — in essence, it is this difference of opinion that allows the entrepreneur to act when others will not do so.

The third important point highlighted in Casson's definition is that when an entrepreneur coordinates scarce resources she or he essentially reallocates them to alternative uses. In other words, Casson's approach is consistent with the Austrian and Schumpeterian notion that the entrepreneur is an agent of change. Unlike Schumpeter, however, Casson is very clear that entrepreneurship is an ongoing function rather than a one-off act of innovation. His argument in support of this contention is that change is endemic in economic systems so entrepreneurs essentially spend most of their time looking out for new information that makes the current allocation of resources appear to be inefficient.

Casson goes on to develop the implications of his definition in some detail and, at the risk of oversimplifying his argument, we can say that he makes the point that in order to execute a reallocation of scarce resources — that is, to carry out the role of coordinator — the entrepreneur must have control over these resources. In a capitalist system this is achieved by taking control of the relevant resources, in other words the entrepreneur has to buy or hire them. This observation is compatible with a number of activities including: starting up a new firm; taking over an inefficient established firm; and acting as an arbitrageur.

Casson extends his theory with an analysis of the crucial role played by the entrepreneur in the setting up of markets (which gives his theory a certain resonance with Schumpeter). The purpose of a market is to allow buyers and sellers to trade with each other. Mainstream economics assumes that markets spontaneously arise and that they are costless to use but Casson points out that markets do not simply appear out of the ether but are constructed by human action, in particular by entrepreneurs.

There are six main obstacles to trade and each arises because of a lack of information:

- (1) the need for the potential buyer and seller to find each other;
- (2) the need for each party to communicate reciprocal wants;
- (3) the need to negotiate a price;
- (4) the need to exchange custody of the goods in return for payment;
- (5) the need to screen for quality of the goods (in other words, are the goods up to the promised specification?);
- (6) the need to be able to enforce compensation if the goods are revealed not to be of the promised specification.

Overcoming each of the six obstacles in turn can be thought of as taking the steps required for a successful trade to take place or, as Casson puts it, each step is designed to take transactors from a state of mutual isolation towards the successful completion of a trade.

Casson's chief point is that if entrepreneurs wish to sell their goods then they have to take the initiative in constructing mechanisms/institutions to overcome these obstacles to trade — customers have little or no role to play here — and, as a result, the costs of setting up a market are borne by the entrepreneur in the first instance. Furthermore, these are sunk costs that typically

have to be made in advance of any trading activity and which continue to be incurred ahead of the receipt of sales revenue. These sunk costs include resources devoted to product development and copyrighting, highly specific tooling and other equipment, signs, logos, and other marketing expenses, and the opportunity cost of the entrepreneur's time. They make the entrepreneur vulnerable, given the uncertainties associated with subsequent revenue.

The strong implication of Casson's perspective is that entrepreneurs need to possess or to acquire excellent bargaining skills if they are to recover upfront investments and correspondingly make a profit from their superior ability at making judgemental decisions. Since entrepreneurs have to perform their function actively, rather than sit back and let the other factors of production do all of the work, Casson does not see entrepreneurial profit as a residual (as in mainstream treatments) but instead as earned income.

### **Using Entrepreneurship as a Departure Point**

We have suggested above that a useful strategy to adopt in teaching introductory pluralist economics is to structure the course so that students are able to discover for themselves some of the basic facts of economic life. But how can we use entrepreneurship to do this? Traditionally introductory economics teaching involves explicitly laying down basic axioms rather than investigation of real world phenomena — it is a 'blackboard subject' (McCloskey, 1999). Using entrepreneurship as a point of departure means that this approach is not viable — not least because there is no unified theory of entrepreneurship. However, far from being a weakness the multiplicity of theories about entrepreneurship is a major strength in terms of providing a forum for accelerating students' attainment of the transferable skill of critical reasoning (Thomson, 2002) that is one of the fundamental aims of a university education.<sup>3</sup> In place of this *theory-first* approach we suggest that it is no bad thing to copy those economists who built their theories on careful observation of real world practices. Three who immediately spring to mind here are Alfred Marshall (1920) and P.W.S. Andrews (1949), and Neil Kay (1997), each of whom developed their respective theories of the firm and industry after careful study of the real world institutions they observed in the economy. As John Kay (1991: 57) tells us: 'Marshall's analysis, and his understanding of the commerce of his day, was sophisticated and wide-ranging. Indeed, Marshall probably knew more about the day-to-day functioning of business than any leading economist this century.'

The way forward then lies in developing an inductive approach to teaching and theory building — this means moving from specific examples towards general theories (Stewart, 1979). The aim here is to provide a forum where students can attempt to make sense of real world phenomena rather than be spoon-fed hard core axioms which they are later expected to apply deductively. This requires us

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<sup>3</sup> Note, however, that differences in rates of progress in this respect may result in pluralistic teaching being seen in very different ways by members of a particular class — cf. the discussion in Earl (1995: 1-11; 2000) of William Perry's six stage taxonomy of intellectual progression.

to begin our teaching with real world data, and the most accessible form of data for non-technical neophytes can be found in case studies. In his discussion of 'post Marshallian' research methods John Finch (1999: 157) points out that: '...case study research is deemed appropriate as it has the potential to uncover anomalies and alternative causal explanations...' This is precisely what a pluralist approach would advocate and it moves economics towards Paul Ormerod's (2003: 73) vision of it, 'as more of a way of thinking about the world which can be of help in understanding a wide range of business, economic and social issues'. Furthermore, in a recent piece of research into different 'teaching-learning environments in economics' Nicola Reimann (2004: 31) cites several (empirical) educational studies, from a multitude of other disciplines, which have, 'emphasised the benefits of an inductive, problem-first approach for active construction of conceptual understanding and the acquisition of expert problem-solving strategies.'

Advocacy of an inductive teaching strategy does not mean that students should be left to formulate ideas unaided; the lecturer is there to guide thinking towards the theories that she or he deems to be important — we should heed David Colander's (2004: 65) point that, 'A good teacher indoctrinates a student; the student and teacher are not on a joint voyage of discovery.' So, where might we expect a case study approach to entrepreneurship lead us?

The first practical hurdle is to obtain some suitable case studies. Typically the case studies available from depositories such as Harvard Business School can be useful but they are not particularly well focussed from an economics perspective. A more suitable but labour intensive approach is for lecturers to write their own cases from published sources. This means they can tailor the case to emphasise the stories they are trying to reveal (a bit like leaving clues in a treasure hunt). This is the strategy adopted in Earl and Wakeley (2005) where we have constructed cases of Richard Branson's early years, Victor Kiam and his buyout of Remington, and James Dyson's struggles to get his Dual Cyclone vacuum cleaners to market. Each of these cases contributes something useful to drawing out various aspects of the three theories of the entrepreneur discussed above. For example, the Richard Branson case study can be used to construct a list of key words or phrases that describe what entrepreneurs do. Our suggested list includes:

- take risks;
- make decisions about entering markets;
- exercise foresight;
- exercise creativity; employ other people; persuade others;
- sell;
- make things happen;
- create companies;
- perceive business opportunities;
- manage the workforce.

Each of these phrases can be used as topic of debate in a classroom setting and can be used in conjunction with the other cases to tease out an understanding of the nature of entrepreneurship. When the various theories of entrepreneurship are introduced to students they are then better able to reconcile the different views or argue for the relevance of one theory relative to another by appealing to the stories to which they have been exposed. But understanding entrepreneurship for its own sake is not the aim, it is instead a stepping-stone for developing a deeper understanding of the true nature of the competitive process. This is the important point.

By confronting students with these kinds of stories, lecturers can begin to build a picture of the dynamics of competition as a process in real time being carried out by real people who suffer from an insufficiency of knowledge. This means that the model of perfect competition, which pervades mainstream teaching, does not need to be given primacy and, consequently, the problems mentioned by Bernstein (2004) above can be mitigated. The fundamental lesson that a profit opportunity for everyone is a benefit to nobody can be taught instead from the perspective of the capabilities approach to economics (George Richardson, 1960/1990; Edith Penrose, 1959). It also means that the formal and informal institutions which provide structure in the economy and which help overcome problems with the insufficiency of knowledge can be brought into the picture at the earliest opportunity (for example, Richard Branson developed Virgin by relying heavily on informal networks of expertise, and he relied on his bank manager for finance).

Ultimately by placing the stories of real life entrepreneurs in front of students and encouraging them to draw out their implications a lecturer can lead students to discover the evolutionary logic which underlies the competitive process (Kenneth Boulding, 1981; Nelson and Winter, 1982; Hodgson, 1999) and avoid trapping them in the restrictive mechanistic metaphor used by mainstream approaches. Evolution will happen because when economic actors are characterised by an insufficiency of knowledge their resource commitments will have to be based on conjectures about the future and the passage of time will prove many of these conjectures wrong. Evidence that conjectures are incorrect will lead to learning and adaptive adjustment (see Harper, 1996).

Hayek (1948: 92) said that, '...the general view seems still to regard the conception of competition currently employed by economists as the significant one and treat that of the businessman as an abuse.' If we place the entrepreneur at the heart of introductory economics this view does not have to persist.

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