Schumpeter's Conduct Model of the Dynamic Entrepreneur: Scope and Distinctiveness

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Abstract

This document outlines a paper by Anthony M. Endres and Christine R. Woods of the University of Auckland, presented by Anthony Endres to the 21st History of Economic Thought Society of Australia conference held at the Rydges Hotel in Parramatta, NSW on 11th July 2008. The paper is titled "Schumpeter's 'Conduct Model of the Dynamic Entrepreneur': Scope and Distinctiveness".

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Contents

1 Overview of the Paper 3

2 Brief Literature Review 3

3 Schumpeter's Conduct Model 4

4 Comparison with Other Models of the Entrepreneur 6

4.1 Neoclassical 6

4.2 Behavioural 6

4.3 Austrian 7

5 Discussion 7

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1 Overview of the Paper

The paper analyses the behavioural aspects of the entrepreneur in Schumpeter's theory of economic development. That is, the paper investigates how, in Schumpeter's model, entrepreneurs behave when making decisions and compares this model with alternative systems of the entrepreneur.

Endres and Woods begin with a definition of entrepreneurial behaviour:

> We define entrepreneurial behaviour as the motives and acts enabling entrepeneurs to reach decisions in their roles as creators of profitable opportunities and as exploiters of those opportunities.

Essentially, entrepreneurs observe and take advantage of prospects. Behavioural aspects of the entrepreneur consider the motivation and capabilities of the entrepreneur.

Three aims of the paper are stated. First, to investigate how entrepeneurs differ, behaviourally, from other economic agents in Schumpeter's and Schumpeter-inspired theories of economic development. Second, to compare Schumpeter's theory of entrepreneurial behaviour with alternative economic theories and third, to consider changes to Schumpeter's theory in subsequent literature.

2 Brief Literature Review

Endres and Woods comment on the sparse literature available investigating developments in theories of entrepreneurial behaviour. They mention that previous studies of Schumpeter's work on the entrepreneur have focussed on the economic role rather than the behaviour aspects of the entrepreneur. They express a need for a specific study of these behavioural facets.

3 Schumpeter's Conduct Model

The first section outlines the conduct model, designated the 'conduct model of the dynamic entrepreneur' by Fritz Machlup (?) which was constructed by Schumpeter in *The Theorie der Wirtschaftlichen Entwicklung* (?).

Essential differences between entrepreneurs and other economic agents turn on 'differences in individual competencies' including 'breadth of horizon,' 'alertness' and 'strength of will.' The hallmark of entrepreneurial behaviour, Schumpeter writes, is the capacity to recognise and exploit newly perceived opportunities (p.5). Schumpeter provides a list of these typical opportunities (?)Schumpeter03:

1. The production and carrying out of new products or new qualities of products.
2. The introduction of new production methods.
3. The creation of new forms of industrial organisation.
4. The opening up of new markets.
5. The opening up of new sources of supply.

Combines the creative process of recognition and exploitation of opportunities. Schumpeter was of the opinion that only a small percentage of individuals have the characteristics necessary to successfully exploit market opportunities.

The development process arises as opportunities emerge in a discontinuous fashion and entrepreneurs take advantage of those opportunities. All acts with an entrepreneurial dimension involves a process of conceiving new combinations between resources given or changing, and ends given or created by producers or consumers.

Rational behaviour for Schumpeter did not mean only optimising behaviour, but included his behavioural aspects of entrepreneurial behaviour.

Entrepreneurial behaviour is special for the following reasons. First, it is distinguishable from general economic behaviour and allocative decisionmaking founded on adaptive, marginalist principles. Second, entrepreneurial behaviour is directed toward something unique and novel. Third, the entrepreneurial act 'presupposes aptitudes differing *in kind* and not in degree from those of mere rational economic behaviour.

Within the class of entrepreneurs Schumpeter creates in his *Theory of Economic Development*, Schumpeter established a fundamental set of differences between entrepreneurs and non-entrepreneurs. Within the entrepreneurial class, there is a continuum of behaviours corresponding to different degrees of entrepreneurial ability.

> Many a one [entrepreneur] can steer a safe course, where no one has yet been; other follow where first another went before; still others only in the crowd, but in this among the first. So also the great political leader of every kind and time is in this type, yet not a unique thing, but only the apex of a period from whicher there is a continuous variation down to the average.

The failure of entrepreneurship is directly linked to over-preparation, special technical knowledge, 'breadth of intellectual understanding [and] talent for logical analysis.' Fundamentally, he says, the basis for originative entrepreneurial conduct is tacit, inarticulable, subjective knowledge, that is, the success of entrepreneurial acts:

> depends upon intuition, the capability for seeing things in a way which afterwards proves to be true, even though it cannot be established at the moment and of grasping the essential fact, discarding the unessential, even though one can give no account of the principles by which this is done.

Note the parallels here between Hayek's position on the importance of intuition for entrepreneurial discovery; the tacit 'know how' in the discovery process.

Different concepts of rationality may be applied. Ordinary economic agents have 'subconscious objective rationality' resulting in mechanical, adaptive behaviour. Entrepreneurs then have 'conscious subjective rationality,' that is, where the entrepreneur makes judgmental decisions about the allocation of resources (?).

Any psychological attribution to the entrepreneurial type was favoured so long as the attribution did not have a hedonistic character. Entrepreneurs do not seek pleasure as an end itself, but prefer to seek out difficulties not avoid them, and delight in ventures with uncertain outcomes. Pecuniary rewards measured success, not motivation. Four aspects of the entrepreneur's conscious, rational conduct:

1. The 'dream and will' to establish private enterprise;
2. The 'sensation of power and independence' associated with commercial activity based on individual action;

3. The element of competition involved in attempting to demonstrate social distinctiveness; and
4. The psychic benefits accruing from the 'joy of creating, of getting things done' or from exercising one's 'energy and ingenuity.'

Any observation of entrepreneurial behaviour will be given specific content by the construction of a 'schema of motivation' which functions heuristically and ascribes a kind of rationality to the behaviour.

4 Comparison with Other Models of the Entrepreneur

After presenting the content of Schumpter's model of the entrepreneur, Endres and Woods discuss the differences between the Schumpeter model and rival entrepreneur systems. For ease of analysis, Table ?? replicates Table 1 from Endres and Woods summarising the comparison of the theories of entrepreneurial behaviour.

4.1 Neoclassical

In the neoclassical model of the entrepreneur, the entrepreneur acts in a system in equilibrium. The system models firm formation; the entrepreneur's actions influence the 'size distribution' of firms. Only entrepreneurs acting as 'automaton maximisers' are part of such a system (Baumol, 1968).

Neoclassical entrepreneurs are 'homogenous ... agents' following a list of specified rules. One notable difference is that under the neoclassical model, entrepreneurs are 'Knightian' risk bearers holding at least a risk neutral attitude. By contrast, Schumpeter depicts capitalists as bearing the risk and not the entrepreneur.

My own observation is that it seems curious the model depicts no risk bearing on the part of the entrepreneur. Given the emphasis on non-financial aspects, one might suggest the entrepreneur risks non-financial factors such as his or her reputation.

4.2 Behavioural

Herbert Simon and 'bounded rationality.' The concept of boundedness describes preprogrammed decision makers who mechanically apply simple rules of thumb.

That is, decision making is determined in a subconscious manner. This ensures they have limited competence relative to the complex situation in which they act.

The study of cognitive processes and cognitive limitations is central to investigating procedurally rational decisions. Schumpeter, instead of advocating investigation of these psychological phenomena insisted studying economic sociology: how entrepreneurs 'came to behave as they do.'

A close study of psychological motivation would undermine the Schumpeterian model of non-rule following, intuitive approach of the entrepreneur.

4.3 Austrian

Here, under the Kirzner's Austrian approach, the emphasis is placed on the tending for entrepreneur's acts to lead markets to equilibrium in the face of correctible entrepreneurial error rather than on entrepreneur's systematic disruption of markets (Bourdeaux, 1994).

A careful reading of the preceding sentence might cause one to suggest the 'creatively destructive' acts of Schumpeter's entrepreneur are consistent with the Austrian ideas.

Under the Kirzner approach, the entrepreneur restores market disequilibrium arising from previously unnoticed profit opportunities and/or from errors brought about by other decisionmakets.

5 Discussion