

**Rebuilding Schumpeter's Theory of Entrepreneurship**

by

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For those who are interested in entrepreneurship, the last few decades have been both exhilarating and frustrating.<sup>1</sup> There has been a general realization, on the one hand, that entrepreneurship is at the center of the type of high and stable economic growth that constitutes prosperity. On the other hand, and despite an avalanche of writings and courses on entrepreneurship, there has been little substantive theoretical progress when it comes to the theory of entrepreneurship itself. While there today exists a valuable and rapidly growing literature on ethnic entrepreneurship, emerging entrepreneurship, women and entrepreneurship, national innovation systems, and so on, there still does not exist one central theory of entrepreneurship, on which the various branches of entrepreneurship can build.

This is where Schumpeter comes into the picture. Of all the theories of entrepreneurship that exist, his theory is still, to my mind, the most fascinating as well as the most promising theory of entrepreneurship that we have. Let me clarify. I do not argue that Schumpeter's theory, as it is understood today, can supply the key to the mystery of entrepreneurship. What I would like to suggest, however, and also devote this paper to, is the argument that it may well constitute the point of departure for the development of *the* theory of entrepreneurship. Hence the title of my paper: rebuilding Schumpeter's theory of entrepreneurship.

In order to use Schumpeter's ideas as one's point of departure for the construction of a new theory of entrepreneurship of Schumpeterian inspiration, at least two things are crucial. First of all, we need considerably better knowledge of Schumpeter's theory of entrepreneurship. And secondly, we need to start suggesting ways for how to complement and add to his theory of entrepreneurship.

Let me say something about both of these tasks. Our knowledge of Schumpeter's theory of entrepreneurship is, despite the giant secondary literature on Schumpeter, still somewhat limited. It is, for example, mainly centered around Chapter 2 in *The Theory of Economic Development*; the rest of Schumpeter's work on the entrepreneur is either not read or not available in English. *Business Cycles*, for example, is not read for what it may teach us about entrepreneurship, and neither is *The Theory of Economic Development* except for its Chapter 2.

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<sup>1</sup> For comments and inspiration I thank Mabel Berezin and Thorbjørn Knudsen.

Still, Schumpeter saw *Business Cycles* as a study that worked out the results of entrepreneurial action, in historical time and in great empirical detail. And *The Theory of Economic Development* (not just its famous Chapter 2) is centered around the entrepreneur and gives expression to a vision of *a whole economy* (as well as a whole economic theory) that is influenced by entrepreneurship: the rate of interest, profit levels, the business cycle and so on.

Finally, even if an attempt has recently been done to translate Schumpeter's most important works on entrepreneurship into English, several bits and pieces still remain. It is also my guess that one should be able to find items in Schumpeter's German production (that is, before 1932 when he moved to the United States) that does not primarily deal with entrepreneurship, but which nonetheless may contain some interesting ideas on this topic.

The second way of developing a new Schumpeterian theory of entrepreneurship – to complement and add to it - is harder to describe, except by example; and later in this paper I will give two examples of what I have in mind. One way to proceed would be to select some aspect of Schumpeter's theory of entrepreneurship and try to add to it.

To give an example: Schumpeter's ideas about financing entrepreneurship. Schumpeter, as we know, argued that it was not the entrepreneur but the capitalist (typically the bank) that shouldered the economic risk. But the relationship between the entrepreneur and the bank is quite different today from what it was in Schumpeter's days. There exist today, for example, venture capitalist firms, and these are often run by former entrepreneurs, who want to be much more actively involved in the entrepreneurial project than what Schumpeter's banker ever was. By focusing on this new development, and theorizing it, one might be able to add to and update Schumpeter's theory of entrepreneurship.

In the first part of this paper I will first try to add to the standard knowledge of Schumpeter's theory of entrepreneurship, and I will do this by presenting the way that this theory appears in the first edition of *The Theory of Economic Development* and not the second (translated) one. This means that the original German edition from 1911 will be used - *Theorie der wirtschaftlichen Entwicklung*, an edition that is not available today and which is rarely read and referred to in the secondary literature on Schumpeter.

My purpose in presenting Schumpeter's ideas in the first edition is simply to make them better known and more easily available. They differ, as I will show, on some interesting points from the 1934 edition, *Theory of Economic Development*. I do not want to suggest that the 1911 edition should replace the 1934 edition. Both editions are gold worth - and both should be available.

### **The Task of Finding out More about Schumpeter's Theory of Entrepreneurship**

There are many reasons for using the first rather than the second edition of *Theorie der wirtschaftlichen Entwicklung*, if one is interested in adding to the standard knowledge of Schumpeter's theory of entrepreneurship. By the latter I mean knowledge that primarily comes from Chapter 2 in the second edition of *Theorie der wirtschaftlichen Entwicklung* (1926), and which today is primarily known in its English translation from a few years later, *The Theory of Economic Development* (1934).

The first edition from 1911 is for one thing much fuller than the 1934 edition – about twice as long. Anyone who knows Schumpeter, knows that this means a treat in the form of twice as many striking formulations since Schumpeter was a brilliant stylist and famous for his *bon mots*. The original edition also contains a long last chapter on economic development, which Schumpeter removed from the second edition.

There is also the fact that when Schumpeter wrote the first edition he was a young and radical economist at a provincial university, the University of Czernowitz in the Austro-Hungarian Empire. At this time Schumpeter was obsessed with the idea of single-handedly trying to revolutionize the science of economics by developing a dynamic theory of economics. When the second edition was translated into English in the early 1930s (by Redvers Opie, under Schumpeter's oversight), its author was in contrast part of the economic establishment in the United States. Schumpeter worked at this time at Harvard University and was presumably more sensitive to what mainstream economics was doing.

By drawing attention to the first and original version of Schumpeter's theory of entrepreneurship, it should be emphasized, I join a distinct and recent trend in Schumpeterian research that argues that we know much too little about the young Schumpeter. This trend began with the work of Yuishi Shionoya and has grown in

strength during the last few years (see e.g. Shionoya 1990, 1997; Swedberg 1991:Ch. 2; Becker and Knudsen 2002; Backhaus 2003; Koppl 2003).

In the rest of this section of the paper I will primarily give an account of Schumpeter's original theory of entrepreneurship, basing myself on Chapter 2 in the 1911 edition, since this is the chapter that is most important for knowledge about his early theory of entrepreneurship. Parts of this chapter exists incidentally in a recent English translation (Schumpeter [1911] 2002).

Chapter 2 in the original edition of *Theorie der wirtschaftlichen Entwicklung* (1911) is entitled "The Fundamental Phenomenon of Economic Development" and deals with what happens in the economic sphere of society, while the rest of society is held constant (politics, population, and so on). The last chapter in the book – the famous Chapter 7 ("The View of the Economy as a Whole") - deals in contrast with the situation when the economic sphere is in interaction with the rest of society (for a recent translation into English, see Schumpeter [1911] 2003).

While Schumpeter's theory of entrepreneurship, as presented in Chapter 2, is centered around what we today would call change, the terminology that Schumpeter uses is distinctly his own. The key term in the book is "development" (more so than "entrepreneurship"), and it covers a very special kind of change, namely the type of change that can only arise *from within* the economic sphere.

But there also exist a different type of changes in the economic sphere, namely those that originate in response to processes *outside* this sphere, and Schumpeter refers to these as "adaptation". "Development" and "adaptation" have nothing in common, and Schumpeter's whole theory of entrepreneurship, as well as his attempt to develop a new type of economic theory, has to do with the distinction between these two different types of change.

The definition of development that Schumpeter provides in Chapter 2 is the following: "By 'development' we shall understand only such changes in economic life that are not forced upon it from without, but arise by its own initiative from within" (Schumpeter [1911] 2002:405). No definition is given of "adaptation", but it is described as economic changes that are not "qualitatively new" and that emerge in response to forces from outside the economy (Schumpeter [1911] 2002:406). This latter type of

change, Schumpeter says, is simply “dragged along”, and as an example he mentions “mere growth” in population (Schumpeter [1911] 2002:405).

Ordinary economic theory (what we today would call neoclassical economics) only deals with static phenomena, according to Schumpeter, while there does not yet exist a theory that is capable of explaining development. Schumpeter’s purpose with Chapter 2, and *Theorie* more generally, was precisely to complement the economic theory of his days with a theory that could deal with development. Later in the chapter Schumpeter introduces the term “entrepreneur” for the economic actor who causes development.

Schumpeter uses the terms “development” and “static” not only as conceptual tools in his attempt to construct a new approach to economic theory, but also to denote concrete economic phenomena that exist in the world. While we may think that most of the economy around us today is dynamic, he says, and in a state of development, this is actually not the case. Nearly everywhere economic reality is static. This is also true for the most dynamic part of economic reality, namely industry. When something really new does happen in industry – say that someone like Carnegie (to use Schumpeter’s example) decides to get rid of some perfectly good machines, because he has found some better machines – everybody is surprised. What we should be wondering at instead, Schumpeter says, is why development takes place in the first place.

Statics – defined as no change or automatic change in response to outside forces – is “the general rule throughout the history of mankind” (Schumpeter [1911] 2002:111). Statics is for example the norm among artisans and peasants. While these are always eager to make some extra money, and work hard in what they do, they only act within given limits.

The artisan does not want to change the way he produces his goods, and the peasant is at the most ready to switch from one type of crop to another to make some extra money. But neither is interested in doing anything that is radically new, and in this they are similar to people in countries like India and China as well as in primitive societies. People in all of these societies, Schumpeter says, are wed to the old; and if they ever make changes, it is only because something happens outside the economy, and they are forced to adapt.

What then accounts for the nearly universal existence of “non-development” in the economy, as Schumpeter calls it? Do not people in static economies also have to satisfy their material needs, and does not this lead to change and development? Not at all, Schumpeter says; most people only try to satisfy their needs within given circumstances. What accounts for the prevalence of static economic behavior is something else, he argues, more precisely two factors. One is sociological in nature, and the other psychological; and together they effectively block development from taking place.

The sociological factor that prevents development from taking place is *other people* or rather other people who are static. The reason for this is that when you try to do something new, other people tend to react negatively. Deviance is something that evokes this reaction in all societies, according to Schumpeter. “Each act of deviant behavior on the part of a member of a community meets with disapproval from the other members” (Schumpeter 1911:118). People react negatively to deviance because they feel psychologically threatened; they are used to always do things in their own habitual and “safe” way. If Sartre says that “hell is other people”, Schumpeter might have said that “what kills entrepreneurship is other people”.

But there is also a psychological factor involved in this process, and that is the resistance to doing something new that each economic actor feels within himself or herself. While doing what is familiar is always easy, Schumpeter says, doing what is new is not. “The whole difference between swimming with the stream and against the stream is to be found here” (Schumpeter 1911:121).

To do the right thing presents few problems as long as everything is known, but it is very different when you find yourself in a new situation. In a static economy “the principle of rational behavior” works perfectly well - but *not* when it is a case of economic development (Schumpeter 1911:123). When you have to do something new, there is no logical or correct answer.

In order for something radically new to emerge, the economic actor has to be bold and willing to take up a fight against the old. Obstacles exist and these have to be overcome. In brief, if there is to be economic development, there has to be *leaders* – those very special people who display energy to act in new ways and are also motivated to do so.

Schumpeter repeatedly refers to this type of person or leader in the 1911 edition as “Man of Action” (*Mann der Tat*), and he describes him as someone who does not accept reality as it is.<sup>2</sup> If there exists no demand for a good, for example, the Man of Action will create such a demand; he will *make* people want it. He (and the Man of Action as well as the entrepreneur is always a “he” for Schumpeter) is full of energy and leaps at the obstacles. Schumpeter writes:

The Man of Action acts in the same decisive manner inside as well as outside the usual tracks in the economy. He does not feel the restrictions that block the actions of the other economic actors. (Schumpeter 1911:132)

The Man of Action, in brief, does not have the same inner obstacles to change as static people or people who avoid doing what is new. What then drives the Man of Action? As opposed to the static person, who goes about his business because he wants to satisfy his needs, and stops once his goal has been accomplished, the leader has other sources of motivation. He charges ahead because he wants power and because he loves to accomplish things.

In Schumpeter’s formulation: “he [the Man of Action] takes pleasure in a social power position and in creating” (Schumpeter 1911:138). This is clearly a point that goes well with economic sociology, we may add. According to *Theorie*, the leader has finally no equilibrium point at which the energy expended equals the satisfaction received – so he will keep fighting till he is too old or otherwise defeated by the forces that the static person does not even think of confronting.

At this point of his argument Schumpeter raises the question if the static person and the Man of Action are not similar in that both want to be satisfied, even if it is in different ways. Do they not have quite a bit in common, and can they not for this very reason be analyzed using the same analytical tools? To my mind, Schumpeter here raises a very interesting question, that is similar to the one that economists often raise today, when they argue that egoism and altruism are basically one and the same thing, since both have a distinct value to the actor. And since this is the case, there is no need to

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<sup>2</sup> While Schumpeter refers to the leader in the 1934 edition he does not use the expression Man of Action.

develop a new type of approach when we deal with something like altruism in economic life; the existing approach, based on egoism, does very well indeed.

How does Schumpeter respond to this type of argument? The answer is that he squarely rejects it and states that it is only a play with words. “The fact that we have to do with two fundamentally different types of behavior, which lead to diametrically opposed results, must not be formulated away” (Schumpeter 1911:149).

Schumpeter also notes that the qualitatively new phenomenon that the Man of Action brings about does not come from nowhere; it already exists in embryonic form in reality. Again, this is a point that goes well with economic sociology. The Man of Action can only bring about “something whose time has come”, as Schumpeter puts it (Schumpeter 1911:152). This argument, it may be added, was often used in Schumpeter’s early days to justify the emphasis on reforms in the Historical School of Economics; and Schumpeter may well have picked it up from there.

As opposed to the situation in static theory, however, what the Man of Action does cannot easily be measured and translated into ordinary science. Development therefore represents a great challenge to economic theory; and the economist has to proceed in ways that are fundamentally different from the ones that are used in static theory. The idea of equilibrium, for example, does not work when it comes to entrepreneurial behavior, and neither do the ideas of marginal utility and rationality.

How then is one to proceed, in order to account for development? Schumpeter’s answer to this question represents what we today would call his theory of entrepreneurship; and it is first at this stage of the argument that he introduces the term “entrepreneur” (*Unternehmer*; Schumpeter 1911:171). Schumpeter explains: “The entrepreneur is our Man of Action in the area of the economy. He is an economic leader, a real and not only an apparent leader as the static leader” (Schumpeter 1911:172).

What is characteristic of the entrepreneur is that he does something qualitative new; and in the area of the economy this means that he recombines or makes a new combination of already existing resources.<sup>3</sup> The entrepreneur, Schumpeter also makes

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<sup>3</sup> As I will return to later, the idea that the entrepreneur makes a new combination of already existing elements in the economy is also to be found in the 1934 edition. The

clear, is not an inventor; he instead introduces “new ways of using *existing* means” or “factors of production” (Schumpeter [1911] 2002:409, 1911:175; emphasis added). In Schumpeter’s formulation: “Our assumption is that he who makes new combinations is an entrepreneur” (Schumpeter 1911:172).

Schumpeter also notes that the number of possible combinations is nearly infinite and that the entrepreneur cannot possibly go through them all in some rational way. His talent consists instead of being able to intuitively select a few that are possible, and decide to go with one of these. The entrepreneur does not make a rational choice, but an intuitive one; and it is the capacity to make the right intuitive choice that separates a good entrepreneur from a bad entrepreneur.

Schumpeter gives several examples of what he means by a new combination in the area of the economy: “the introduction of a new quality of a good, or a new use of an already existing good, [...] a new production method, [...] the opening up of a new market [and] the change of economic organization, e.g., in founding a trust, establishing a large corporation, etc.” (Schumpeter [1911] 2002:410).<sup>4</sup> He also states that the most common form of entrepreneurship is to create a new firm: “the most typical case representing all the different possibilities and all the different sides of the matter, the organizational, commercial, technical side, etc. *is the founding of a new enterprise*” (*Unternehmung*; Schumpeter [1911] 2002:410).

What is absolutely crucial for the entrepreneur is to be able to envision a new combination; and as opposed to the static person, this is something that comes easily to him. While the universe of the static person is limited to the combinations that already exist, the entrepreneur wants to move away from these and create a new combination in some part of the economy. Where the static person sees nothing but routine, the entrepreneur knows that there exists a nearly endless number of new ways of doing things.

But knowing that there exist different ways of doing things is not enough to turn someone into an entrepreneur, according to Schumpeter. “Always and everywhere there

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later edition draws a similarly sharp conceptual line between the inventor and the innovator.

<sup>4</sup> One can find a very similar formulation of possible innovations in the 1934 edition (see Schumpeter 1934:66).

is a richness of ideas and plans” (Schumpeter 1911:177). It is true, he says, that there is only a minority of people who have the capacity to envision that things can be done in a different way. And it is also true that only a minority of *this* minority has the force to transform one of these new combinations into reality.

But ideas are cheap, Schumpeter says, and what is truly difficult to face is the risk and uncertainty that comes with doing something in reality, not just in your mind. Schumpeter makes this point with so much force in *Theorie* that one must conclude that he at this stage clearly prioritized the concrete tasks of the entrepreneur over the thinking. This is an interesting point and also one that would recede in the 1934 edition.

In order to successfully carry out an entrepreneurial enterprise, the leader also needs the cooperation of other people. The problem with this is that other people are typically static and do not want to take the risk of doing anything new. “The disposition of the mass of people is static and hedonistic”, while “new enterprises mean new dangers that may cost you your existence” (Schumpeter 1911:183). The way out of this dilemma for the entrepreneur, according to Schumpeter, is to buy the labor power of other people and order them to do what is new.

To be in a position to buy the cooperation of workers and employees, the entrepreneur needs money; and this is where the banker or the capitalist enters into Schumpeter’s theory. The entrepreneur borrows money that has been created by the banks, and in this manner finances his enterprise. “The principle is this: the entrepreneur buys productive labor and thereby removes it from its ordinary static use; he makes use of it without asking its owners for permission; and in this way he forces the economy into new directions” (Schumpeter 1911:189).

Schumpeter sums up the argument in Chapter 2 of *Theorie* as follows: “*Like the carrying out of new combinations is the form and content of development, the activity of the leader is the driving form*” (Schumpeter [1911] 2002:434). Entrepreneurship, in brief, represents a very special type of economic change – more precisely a type of change that consists of a new combination that is translated into reality by a leader. All other changes in the economy lack a dynamic element and are fundamentally passive. Here, as elsewhere, the Man of Action is divided from the Static Person by an unbridgeable gap (see Table 1).

/Table 1 about here/<sup>5</sup>

Before leaving the 1911 edition, a few words also need to be said about its last chapter, Chapter 7, which was eliminated in later editions. This chapter is entitled “The View of the Economy as a Whole”, and is centered around Schumpeter’s idea that the concept of the entrepreneur not only constitutes a key to the economic sphere but to all other spheres in society, such as politics, art and so on. While Schumpeter’s argument on this point is interesting, I will not discuss it in this paper, but only note that Chapter 7 contains a very strong formulation of Schumpeter’s idea that dynamic theory rejects the idea of equilibrium:

There is no such thing as a dynamic equilibrium. Development, in its deepest character, constitutes a disturbance of the existing static equilibrium and shows no tendency at all to strive again for that or any other form of equilibrium...If the economy does reach a new state of equilibrium then this is achieved not by the motive forces of development, but rather by a reaction against it. Other forces bring development to an end, and by so doing create the first precondition regaining a new equilibrium. (Schumpeter [1911] 2003:76)

To this should be added that just as Schumpeter removed Chapter 7 from later editions of *Theorie*, he also eliminated much of this radical emphasis on dynamics and the idea that entrepreneurial change can *never* be at rest or reach an equilibrium. In the 1934 edition he chose instead to emphasize what he termed the discontinuous nature of economic reality and that it moved from one equilibrium to another – a formulation that is quite similar to the one that he in 1911 had used to characterize static theory (Schumpeter 1934:64). It should also be noted that the term “dynamics” is not used in the 1934 edition, and the reason for this, according to the author, is that it has acquired too many meanings (Schumpeter 1934:64, n.1; cf. 82-3).

### **Schumpeterian Ideas on Which to Build, Part 1**

At the risk of leaving Chapter 7 and the 1911 edition a bit too abruptly, I shall now proceed to the part of my paper where I will try to single out important

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<sup>5</sup> For Table 1, see the end of the article.

Schumpeterian ideas about entrepreneurship that I think we can build on. This represents a way to use Schumpeter to, so to speak, surpass Schumpeter.

The first of the ideas that I would like to discuss is his concept of *combination*. Schumpeter famously defines entrepreneurship as a new way of combining things, so it is indeed a central concept. It can be found, as already noted, in the 1911 edition, in essentially the same sense as it is used in the 1934 edition; and I shall now switch to the latter edition since it is better known, more accessible and represents a later formulation.

Let us first see how Schumpeter himself uses the concept of combination. As far as I can see he uses it in two different ways. First of all, he sees it as central to the economic process in general; and second, he sees it as central to the definition of entrepreneurship.

The very first use of “combination” can be found in Chapter 1 of *The Theory of Economic Development*, which is devoted to the topic of the circular flow of economic life. Schumpeter writes:

An enterprise as such and even the productive combinations of the whole economic system we shall also regard as ‘combinations’. This concept plays a considerable part in our analysis. (Schumpeter 1934:14)

Schumpeter also argues that one should distinguish between “economic combinations” and “technological combinations”. Economic logic, he argues, typically prevails over technological logic. “As a consequence”, he writes, “we see all around us in real life faulty ropes instead of steel hawsers, defective draught animals instead of show breeds”, and so on (Schumpeter 1934:14-15).

In Chapter 2 of *The Theory of Economic Development* Schumpeter uses the concept of combination in a different sense, namely to define entrepreneurship. His famous definition of the entrepreneur is as follows: “The carrying out of new combinations we call ‘enterprise’; the individuals whose function it is to carry them out we call ‘entrepreneurs’” (Schumpeter 1934:74). To Schumpeter, for whom development equalled entrepreneurship, “development in our sense is then defined by the carrying out of new combinations” (Schumpeter 1934:66).

When Schumpeter presents the two meanings of the term combination in this way, it is easy to see how they belong together and even seem to grow out of each other. This

way of looking at things, however, does not give Schumpeter proper credit for the theoretical work he had had to put into this question, in order to make the two meanings of combination become so close. There is also the fact that the idea of *entrepreneurship* as a way of combining the different parts of production into some new way, actually has a history; and for this we have to turn elsewhere in Schumpeter's work than the editions of *Theorie*.

The first person to suggest that the core of entrepreneurship consisted in the idea of combination was, according to Schumpeter, Jean-Baptiste Say. Schumpeter's fullest description of Say's contribution in this regard can be found in *History of Economic Analysis*. We here read about Say:

His contribution [to the theory of entrepreneurship] can be summed up in the pithy statement that the entrepreneur's function is to *combine* the factors of production into a producing organism. Such a statement may indeed mean much or little. He certainly failed to make full use of it and presumably did not see all its analytical possibilities. He did realize, to some extent, that a greatly improved theory of the economic process might be derived by making the entrepreneur in the analytic schema what he is in capitalist reality, the pivot on which everything hinges. (Schumpeter 1954:555).

In a long footnote that Schumpeter adds to this statement, he also fends off the objection that Cantillon and Adam Smith had developed the idea of entrepreneurship as combination well before Say. According to Schumpeter, Cantillon had said something quite differently, namely that the entrepreneur buys at certain prices with the intent to sell at uncertain but predicted prices. And Adam Smith's theory of entrepreneurship was, according to Schumpeter, contained in the notion that the entrepreneur is the capitalist who lends other people money.

Schumpeter concludes his discussion of the role of the concept of combination in Cantillon and Adam Smith in the following way:

It might be said that the distinctive function that Say made explicit is implied both by Cantillon and Smith. But analytic progress – not only in

economics – hinges in great part on making things explicit that have been implied or implicitly recognized for ages. (Schumpeter 1954:555)

Let us now leave Say and return to *The Theory of Economic Development* and the idea that entrepreneurship consists of making new combinations. The first thing that we want to know is what exactly does a new combination look like? First of all, Schumpeter tells us – just as in the 1911 edition - that a new combination is not the same as an invention. The reason for this is the following: “as long as they are not carried into practice, inventions are economically irrelevant” (Schumpeter 1934:88).

A new combination – what Schumpeter also calls an innovation – is usually defined by him as a way of combining already existing “resources”, “materials” or “means of production” in some novel way (e.g. Schumpeter 1934:65, 68). The terminology that Schumpeter uses - “resources, “materials” or “means of production” – is interesting in itself, because it points to the fact that he was ready to accept quite a bit of different items as building blocks in the economic process.

Does Schumpeter provide any examples of these new combinations? Yes, he does. In one of the book’s most cited passages (which can also be found in the 1911 edition) Schumpeter enumerates five of these new combinations. The first is “the introduction of a new good”, the second “the introduction of a new method of production”, and so on (Schumpeter 1934:65).

Let us stop here for a moment. Would it be possible to develop a model for what novel combinations would look like? We know, for example, from modern genetics and DNA, how important the notion of combination is, and what huge numbers of possible combinations may result from just a few basic elements.

Schumpeter himself had briefly touched on this possibility, as we recall from the account of Chapter 2 in the 1911 edition, where he says that one can combine things in an infinite number of ways. Schumpeter also thought that rational thought was of little use here; and that the only way that the entrepreneur could handle the nearly unlimited number of choices was through *intuition*. The entrepreneur, in other words, simply bypasses the difficult problem of calculated choice by relying on intuition. Is this a clue that we today want to pick up on, by developing a theory of entrepreneurship centered around a scientific theory of intuition? If so, what would such a

theory look like? Can you argue, for example, that because of his or her background, an entrepreneur is likely to react in a certain way; and in this manner develop, say, an economic-sociological theory of entrepreneurship? Would not this way of arguing, however, be faulty since we would predict that just about everybody with this background would be entrepreneurial material – something that is not likely to be true.

Would it be better to use a psychological approach, say along the lines of behavioral economics, where experiments are used rather than surveys and historical of the type that sociologists favor? There already exist experiments, for example, that show that some people are much better than others at figuring out if somebody is telling the truth or not. Would there also be some way of establishing which people have better economic intuitions than others; who is a Man of Action and who is a Static Person, so to speak?

Let me suggest another way as well of thinking about entrepreneurship and combinations. If you take the five types of innovations that Schumpeter mentions in his famous passage, you will find that they deal with the following areas: “a new good”, “a new method of production”, “a new market”, “a new source of supply of raw material or half-manufactured goods”, and “a new organization of an industry” (Schumpeter 1934:66). Now, if we add all of these together, so to speak, what do we get? The answer, I suggest, indicates that Schumpeter’s seemingly innocuous list of innovations is quite systematic in nature; and the reason for this is that the five types of innovation cover the production of a good (for a firm or a whole economy) from the beginning to the end. Schumpeter starts with raw material, then proceeds to the process of production, the good itself, the market and the organization of the market.

What we have, in brief, is a number of steps that together make up the process that begins with the production of a good, all the way to its sale on the market. Entrepreneurship means to vary one of these factors from A to Z, so to speak.

This way of reconceptualizing Schumpeter’s notion of entrepreneurship as a form of continuous combination may be of use in developing a Schumpeterian theory of entrepreneurship. By conceiving the “production” of a firm as a unitary process of sorts it may be easier to handle the idea of combination, in the sense that we know that there only exist five units so to speak. We realize also, for example, that very successful innovations

may involve several innovations (a maximum of five to be precise, if we stick to Schumpeter's list).

Another way of going beyond Schumpeter would be to pick up on the idea of a unitary economic process (from production to sale), but to divide it in a different way than what Schumpeter does. Instead of there being five elements, we may for example have a higher (or a lower) number; we may also choose other units/elements than those that Schumpeter selected. It is clear, for example, that Schumpeter pays too little attention to the organization of the firm, so we would perhaps like to change his scheme to make room for changes on this score. Other changes are conceivable as well.

My own view is that we may also want to complement Schumpeter's ideas on the economic process on one special point, and what I have in mind is actually a very Schumpeterian point. This is the notion that the economic process of entrepreneurship is not over once the goods are on the market; the entrepreneur also has to make a profit.

This point may seem trivial, but this is not how I see it. If we recall Schumpeter's argument in Chapter 1 that it is important to distinguish between "technological combinations" and "economic combinations", and that the former always have to give way to the logic of the economy, we realize that all of Schumpeterian innovations – the new good, the new method of production, and so on – are only of interest (are only innovations!) if they make it possible for there to be a profit. The demand for profit weeds out many possible combinations, one could also say.

I feel that this last point is important because the fact that an entrepreneur always has to make a profit is a factor that tends to get lost in quite a few modern works on entrepreneurship. The entrepreneurial process, then, starts for Schumpeter with the production of a good, and it ends first when the profit is safely in the hands of the entrepreneur. Introducing a new good, a new method of production, and so on may well be commendable and "entrepreneurial", as we use this word in everyday language, but unless there also is profit, there is no (Schumpeterian) entrepreneurship.

This way of adding to or clarifying Schumpeter's position may also be helpful in conceptualizing *failed entrepreneurship*. As an example of this I would like to refer to a very interesting study by Swedish economic historian Torsten Gårdlund, entitled *Geniuses of Failure* (1993). The author discusses a handful of brilliant Swedish

businessmen who went through all of the Schumpeterian steps – but failed to make a profit. These businessmen constitute, one could say a special type of entrepreneur (“geniuses of failure”), just like the inventor differs from the innovator. But while they may be entrepreneurs, in the sense that this word is used in everyday language, they are not (in the Schumpeterian sense) *economic entrepreneurs*.<sup>6</sup>

Gårdlund also notes that once one of these the failed geniuses had blazed the trail, so to speak, someone with a better sense for how to make money often came around, picked up the pieces and made a profit. What this tells us – and I will end the section on the concept of combination with this suggestion – is that the combinatorial process, if I may call it so, can be divided into different segments, each of which may be carried out by different people or organizations. From this perspective, the entrepreneur can be one person, several persons, one organization and perhaps even several organizations.

### **Schumpeterian Ideas on Which to Build, Part 2**

My second candidate for a suggestive Schumpeterian idea, which we may want to build on and add to, is the notion that there exists a resistance to the entrepreneur that has to be overcome, if there is to be an innovation or a new combination. I will refer to the central element here as *resistance (to innovation or entrepreneurship)*, but there does not exist one single concept or word that Schumpeter uses to denote this part of his theory. Again I will first present Schumpeter’s ideas and then suggest some additions.

The idea of resistance to entrepreneurship is present in Chapter 1 of *The Theory of Economic Development* (1934) on the circular flow of economic life, but Schumpeter does not single it out, and the reader does not understand how central it is to his theory of entrepreneurship until Chapter 2. In any case, Schumpeter, mentions for example how the farmer, because of tradition, keeps repeating his production year in and year out; and that tradition has “bequeathed him definite means and methods of production [and] all these hold him in iron fetters in his tracks” (Schumpeter 1934:6).

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<sup>6</sup> The term “economic entrepreneur” might seem redundant, but there has recently been such an inflation in the use of the term “entrepreneur” – think of moral entrepreneur, political entrepreneur, institutional entrepreneur and most recently social entrepreneur! - that the expression “economic entrepreneurs” has become necessary.

This way of phrasing things may give the impression that Schumpeter views tradition as working from the outside on the economic actor, but this is not the case. The traditional actor, he says, also wants *not* to change, even when the circumstances change. “Everyone will cling as tightly as possible to habitual economic methods and only submit to the pressure of circumstances as it becomes necessary” (Schumpeter 1934:8).

In Chapter 2 of the 1934 edition one can find a much fuller and systematic discussion of resistance to innovation than in Chapter 1, and how these may be overcome. The resistance, Schumpeter here says, can be divided into three types. First, there is the resistance that is associated with “the task”; then there is the resistance associated with “the psyche of the businessman”; and finally there is the resistance from “the social environment” (Schumpeter 1934:86).

As to type number one – resistance to a new task – Schumpeter means by this that the economic actor will now have to do something that is not part of the circular flow and that he has never done before. As a result, the actor lacks “data” for his decision as well as “rules of conduct” that tell him what to do (Schumpeter 1934:84-5). The economic actor “must [now] really to some extent do what tradition does for him in everyday life, viz. consciously plan his conduct in every particular”.

The businessman has as a consequence to constantly think things through, which means that there will be “much more conscious rationality in this than in customary action” (Schumpeter 1934:85). But since it is impossible to figure everything out (even in modern society, where life is becoming increasingly rational), the businessman has to somehow make a decision anyway. This brings us back to the element of intuition; and in the last hand, Schumpeter says, “the success of everything depends on intuition” (Schumpeter 1934:85).

The second type of resistance is to be found in the businessman himself and the way that he feels and thinks about doing something new. People have an inborn tendency to avoid what is new, Schumpeter says, as exemplified by the fact that people are reluctant to innovate even when there is no objective resistance. By objective resistance Schumpeter means the task to be carried out as well as resistance from the social environment.

Once you are settled in a routine, Schumpeter specifies, “thought turns again and again into the accustomed tracks” (Schumpeter 1934:86). To break away from these routines is very difficult, and few people have that “great surplus of force” or “mental freedom” that is needed to do so (Schumpeter 1934:86).

The third type of resistance consists of “the reaction of the social environment” and includes, first of all, “legal or political impediments” (Schumpeter 1934:87). More importantly, however, there is also the hostility that any population of people tends to show to those who behave in a different way. Schumpeter notes, for example, that people are usually quick to spot and condemn differences in dress and manners. They are even more hostile, he adds, when it comes to behavior that is different in areas that are more important to them, including the economy.

This is all the more the case, Schumpeter says, since certain groups have a material interest in the status quo. He sums up what an entrepreneur has to do in order to overcome the resistance in his environment in the following way:

Surmounting this opposition is always a special kind of task which does not exist in the customary course of life, a task which also requires a special kind of conduct. In matters economic this resistance manifests itself first of all in the groups threatened by the innovation, then in the difficulty in finding the necessary cooperation, finally in the difficulty of winning over consumers. (Schumpeter 1934:87)

That the hostility in the social environment towards an entrepreneur can be extremely strong can be illustrated with an example that Schumpeter uses at one point in *Business Cycles*. In his discussion of early European economic history Schumpeter says that “entrepreneurs were not necessarily strangled but they were not infrequently in danger of their lives” (Schumpeter 1939:Vol. 1, 243). To this statement a footnote is added, in which Schumpeter cites a document that tells about an entrepreneur who was strangled to death in 1579 in Danzig. Since the accuracy of the source is unsure, Schumpeter adds in Italian “*se non è vero è ben trovato*” – “if it is not true, it is well said”.

Before leaving Schumpeter’s account of resistance to entrepreneurship in *The Theory of Economic Development*, a few words need to be said about what exactly he

means by such resistance. As usual, Schumpeter presents us with some splendid metaphors. At one point, for example, he says that “all knowledge and habit once acquired becomes as firmly rooted in ourselves as a railway embankment in the earth” (Schumpeter 1934:84). And at another point he says that “carrying out a new plan and acting according to a customary one are things as different as making a road and walking along it” (Schumpeter 1934:85).

But even if these metaphors are suggestive, it has to be admitted that Schumpeter’s terminology about resistance is somewhat imprecise. The idea of resistance covers a number of phenomena that are typically held apart in today’s social science – such as “habit”, “custom”, “tradition”, and so on. To some extent, this may simply reflect the fact that Schumpeter discusses three different types of resistance. But when we try to pair off habit, custom and so on, with the three types of resistance (a new task, the psyche of the businessman and the social environment), there is no automatic fit. Resistance to a new task seems primarily to be associated with tradition and custom; resistance in one’s mind, to habit and custom; and reactions of the social environment, to custom. Buy why does not tradition play a role in the latter type of resistance; why is habit not part of the resistance to a new task; and so on?

The confusion on this point gives me an opportunity to step in and suggest a way of complementing and adding to Schumpeter’s thought. It needs to be complemented, first of all, with the concept of *norm* - that is, with the notion that there exist regular forms of behavior that people want to see followed or they will react with some kind of sanction (positive or negative).

One reason for bringing up the concept of norm in this context is that the elements of tradition and custom are more important in pre-industrial society than in modern society. To include the concept of norm in the discussion would, from this perspective, represent a way of updating Schumpeter. Another reason is simply that the concept of norms is a concept that Schumpeter seems to have missed.

It is also possible to create a direct link between the idea of combination and that of resistance, and in this way add to Schumpeter’s theory. A Schumpeterian combination, to recall, consists of six elements, five of which Schumpeter discusses in his typology of innovation, plus the demand that there has to be a profit. Now, one could argue that in an

established industry the way that you have to behave in *all* of these six parts adds up to a norm, a custom, a habit and so on for how things should be done – a model to follow, in short. If you want to produce, say, an electric fan, this is the raw material you should use, these methods of production are suitable, and so on. An existing combination, in brief, gets its power of resistance from the fact that it constitutes a norm, a custom and so on.

One could also argue, as a variation on this theme, that different norms, customs, habits and so on can be found at each of the six steps in the process of production.<sup>7</sup> An industry tends to be organized in some special way, its methods of production tend to be such and such, and so on. Resistance to innovation is perhaps also different in all of these cases. Each of the six steps in the economic process constitutes its own norm.

Up till now I have discussed Schumpeter's terms of habit, custom and tradition, and added the concept of norm; and I have done this in order to get closer to the kind of resistance that the entrepreneur is likely to encounter when something new is being tried out - be it in the way that the whole process of production is organized or just in one of its parts. Each of these resistances is presumably somewhat different in nature; and in this sense also teaches us something new about entrepreneurship.

A *habit* can be defined as repeated forms of the behavior of an individual, and here the resistance consists of breaking with the way that things are regularly done.<sup>8</sup> A *custom* is more social in nature, in that many people are needed for there to be a custom. But it is otherwise similar to habit, in that there does not exist any force beyond the memory of the past behavior that adds to the resistance to the new behavior.

Such a force, however, exists when it comes to tradition and norms. In a *tradition*, behavior is repeated, and not only because that is how things have always been done. To some extent the past also validates the repeated behavior. It is seen as legitimate *because*

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<sup>7</sup> This idea is close to the idea in the French School of Conventions that the most important analytical fact about economic life is that it has to be co-ordinated through *conventions*. For an attempt to make a connection between this school of thought and Schumpeter's notion of the entrepreneur, see Swedberg (2006).

<sup>8</sup> For helpful definitions of habit, custom and tradition, see e.g. paragraph 4 in Weber's *Economy and Society* (Weber 1978:29-31). Weber's term for norm is convention. For habit, see also Charles Camic (1986).

it is traditional, and in this sense it is good to follow a tradition (“this is how things have always been done - and also how they should be done!”).

In a *norm* this same element of approval (or disapproval) is also very much present, but it has nothing to do with age or the past. The normative element is much more varied instead connected to something else, such as the strong element of shame that is attached to the norm against incest.

An entrepreneur, to summarize the argument so far, must face the existing habits-traditions-customs-norms that are attached to the current way of doing things, and somehow still be able to push through a new combination. My sense as a sociologist is, however, that we may want to develop this line of thought a bit further. What I especially have in mind is that the terms “custom”, “habit” and “tradition” – as well as “norm” - may not capture what is going on in modern industry all that well.

By this statement I mean that even if we acknowledge that there do exist combinations for how things are done in various parts of economic life, Schumpeter’s terms (plus the concept of norm) may not be so good in capturing what is actually going on. The main reason for this is that all of them were originally designed by social scientists to analyze social life in general, rather than economic life in advanced capitalism.

They are all also fairly old social science terms, and the world is changing quickly. The forces of say “tradition” are not very strong in contemporary industry; and the idea of, say, “economic norms” may not be so useful in a situation where many CEOs know that constant change has to be on the agenda or their corporations will go under.

What then to do? My suggestion is that we may want to keep the old terms and see how well they fit or not fit what happens in the economy. But we could also try to develop a new and better terminology that would be assigned the task of expressing, in as precise way as possible, the hold that we think combinations may have on businessmen today.

My own candidate on this score would be to use the term “*order*”, a term that has a Weberian past but which is otherwise not too much burdened or associated with current social science notions. According to Weber, an order (*Ordnung*) can be defined as a prescription for how to act or a model to follow (e.g. Weber 1978:31-3). The idea would

be that a whole combination (and, alternatively, parts of such a combination), typically constitutes an *order* in the modern economy; and that this is what the modern entrepreneur is up against.

By using the term “order”, I also have in mind the simple fact that people like things to be in order, and that things need to be in order if anything is to be accomplished. Orders tend to look “normal”, but they are not necessarily infused with the type of strong and explicit sentiments that are linked to the concept of norm (except, perhaps, that *disorder* is usually frowned upon). The challenge for the modern entrepreneur, in brief, would be to replace an existing order with a new one.

### **Concluding Remarks**

While the ideas I have presented in this paper do not solve our central problem – to develop a new and powerful theory of entrepreneurship – they do point to some tasks that we may want to undertake, while waiting for the new theory of Schumpeterian entrepreneurship to be invented. In the first part of the paper, where I presented Schumpeter’s ideas on entrepreneurship in the 1911 edition of *Theorie der wirtschaftlichen Entwicklung*, I tried to show that we need more information than we currently have on what Schumpeter has said about entrepreneurship.

This is especially the case if we seriously want to engage in the project of trying to complement and add to Schumpeter’s theory of entrepreneurship. If this is the case, our interest in what Schumpeter has said about the entrepreneur and entrepreneurship at various points in his works, does not only have a historical interest to us, but also acquires a potentially analytical one.

The analytical task of reconstructing a Schumpeterian theory of entrepreneurship represents, of course, the most important as well as the most difficult and elusive part of the enterprise I have tried to outline. My own suggestions have been to single out and focus on Schumpeter’s two concepts of combination and resistance to entrepreneurship. But one can imagine others as well; and, the general truth about all research is also applicable here: whatever works, works.

But, again, till the theoretical breakthrough occurs, there are some modest tasks that need to be carried out. When it comes to the idea of combination, I think that some

kind of creative formalization may be possible; and I am currently involved in an enterprise of this type with my colleague Thorbjørn Knudsen at Odense University. Hopefully we will have something to show along these lines in about a year.

As to the idea of *orders* as obstacles to the development of new entrepreneurial combinations, I think that this project invites to some immediate tasks. One may, for example, draw up an empirical research program for trying to investigate how strong these orders are and what their structure is like. This also goes for profit itself, since there may be definite opinions in an industry about what the profit should be and how it should be acquired.

Schumpeter, in all brevity, should not be counted out. Not only must he be credited with having produced, nearly a century ago, what is still the most interesting theory of entrepreneurship. Add to this that Schumpeter's ideas are also very suggestive – and that they may be of help in developing that theory of entrepreneurship that economists have been looking for ever since Schumpeter.

Table 1. Schumpeter in 1911: The Man of Action versus The Static Person

**The Man of Action**

dynamic  
 breaks out of an equilibrium  
 does what is new  
 active, energetic  
 leader  
 puts together new combinations  
 feels no inner resistance to change  
 battles resistance to his actions  
 makes an intuitive choice among a  
     multitude of new alternatives  
 motivated by power and  
     joy in creation  
 commands no resources but  
     borrows from a bank

**The Static Person**

static  
 seeks an equilibrium  
 repeats what has already been done  
 passive, low energy  
 follower  
 accepts existing ways of doing things  
 feels strong inner resistance to change  
 feels hostility to new actions of others  
 makes a rational choice among existing  
     alternatives  
 motivated exclusively by needs  
     and stops when these are satisfied  
 commands no resources and has no  
     use for new resources

*Comment:* In *Theorie der wirtschaftlichen Entwicklung* (1911) Schumpeter contrasts the entrepreneurial to non-entrepreneurial person in a much more detailed fashion than in *The Theory of Economic Development* (1934). He refers to the former as the Man of Action (*Mann der Tat*) and the latter as static. All populations can be divided into a small number of Men of Action and a mass of static or non-entrepreneurial individuals. This is something that goes for the economy as well as other areas of society (Chapter 7).

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