

THEORIES OF ENTREPRENEURSHIP

It is a universal fact that entrepreneurship is an important factor in economic development.

An Entrepreneur is the risk bearer and works under uncertainty. But no attempts were made by economists for formulating systematic theory of entrepreneurship.

However, different theoretical assumptions of entrepreneurship focus on three major aspects of entrepreneurship. These three aspects are nature of opportunities, the nature of entrepreneurs, and the nature of decision-making framework within which an entrepreneur functions. These three aspects give rise to two logical, consistent theories of entrepreneurship, namely, discovery theory and creative theory.

Some of the theories of entrepreneurship are: -

1. Innovation Theory
2. Need for Achievement Theory
3. Status Withdrawal Theory
4. Theory of Social Change
5. Theory of Social Behaviour
6. Theory of Leadership
7. Theory of Model Personality
8. Theory of Systematic Innovation
9. Creation Theory
10. Psychological Theory
11. Sociological Theory
12. Economic Theory
13. Cultural Theory.

Theories of Entrepreneurship – 8 Major Theories with Critical Evaluation

It is a universal fact that entrepreneurship is an important factor in economic development. An Entrepreneur is the risk bearer and works under uncertainty. But no attempts were made by economists for formulating systematic theory of entrepreneurship. According to William J. Baumol, the economic theory has failed to provide a satisfactory analysis of either the role

of the entrepreneurship or its supply. The traditional notion of an entrepreneur is that he brings together the factor inputs and organises productive activity. The traditional models treat the entrepreneurial function like a managerial function.

Similarly, in modern growth theory also, any contribution of entrepreneurship is typically contained in a residual factor. This residual, variously termed as 'technical change' or 'coefficient of ignorance'. It includes among other things, technology, education, institutional organisation and entrepreneurship.

Different thinkers have evolved different theories of entrepreneurship.

Salient features of these theories are as follows:

Theory # 1. Innovation Theory:

This theory was propounded by J.A. Schumpeter. According to Schumpeter, entrepreneur is basically an innovator and innovator is one who introduces new combinations.

In practice, new combination theory covers five cases which are given below:

- (i) The introduction of a new good which consumers, are not yet familiar—or of a new quality of a good.
- (ii) The introduction of a new method of production, that one not yet tested by experience in the branch of manufacture concerned, which need by no means be founded upon a discovery scientifically new and can also exist in a new way of handling a commodity commercially.
- (iii) The opening of a new market i.e. a market into which the particular branch of manufacture of the country in question has not previously entered, whether or not this market has existed before.
- (iv) The conquest of a new source of supply of raw materials or half manufactured goods, irrespective of whether this source already exists or whether it has first to be created.
- (v) The carrying out of the new organisation of any industry like the creation of a monopoly position (for example, through trustification) or the breaking up of a monopoly position.

Critical Evaluation:

In Schumpeterian theory, the main theme is the innovation. He makes a distinction between an innovator and an inventor. According to him, an inventor discovers new methods and new materials. But, an innovator is one who applies inventions and discoveries in order to make new combinations. With the help of these new combinations, he produces newer and better goods which yield satisfaction as well as profits.

In economic development process, entrepreneurs have been assigned a crucial role so that tempo of growth is maintained effectively. Development requires basic changes and entrepreneurs carry out the required changes. Thus, entrepreneurial development brings economic development.

Schumpeter's concept of entrepreneurship is quite broad based. Entrepreneurship includes not only the independent business men but also executives and managers who actually undertake innovative functions.

However, Schumpeter's theory suffers from following limitations:

(i) It excludes individuals who merely operate an established business without performing innovative functions.

(ii) Innovating entrepreneur represents the most vigorous type of enterprise. However, this type of entrepreneur is rarely available in developing countries

(iii) It laid too much emphasis on innovative functions. But it ignores the risk taking and organising aspects of entrepreneurship.

(iv) It assumes an entrepreneur as a large scale business man. He is a person who creates something new. But in practice, an entrepreneur cannot have large scale operations from the very beginning,

(v) It fails to provide a suitable answer to question like— why some countries had more entrepreneurial talent than others?

According to Schumpeter, entrepreneurs are not a class in themselves like capitalists and workers. An individual is an entrepreneur only when he actually carries out new combinations and ceases to be an entrepreneur the moment he settles down to running the established business.

According to Schumpeter, an entrepreneur exists only if the factors of production are combined for the first time. Maintenance of a combination is not an entrepreneurial activity. In this way, combination theory differs from the theory of rent formulated by Ricardo. Ricardo included the term "entrepreneurial ability" as an independent factor of production and it is concerned with profit. Thus, this theory fails to provide suitable solutions to the problems.

Theory # 2. Need for Achievement Theory:

This theory was developed by David. C. McClelland. McClelland concerned himself with economic growth and the factors that influence it. In this context, he tries to find the internal factors i.e. "human values and motives that lead man to exploit opportunities, to take advantage of favourable trade conditions." That is why he gives importance to the innovative characteristics of entrepreneurial role. The entrepreneur is concerned with need for achievement (n-achievement).

The n-achievement is called as "a desire to do well, not so much for the sake of social recognition or prestige, but for the sake of an inner feeling of personal accomplishment."

It is this motive of n-achievement that guides the actions of entrepreneur. People with high n-achievement behave in an entrepreneurial way. So it is better to develop n-achievement among individuals to ensure high scale of economic development. In practice, n-achievement

motive is inculcated through child rearing practices, which stress standards of excellence, material warmth, self-reliance, training and low father dominance.

McClelland identified two characteristics of entrepreneurship. First doing things in a new and better way. Secondly, decision making under uncertainty.

This motive is called as the tendency to strive for success in situations involving an evaluation of one's performance in relation to some standard of excellence. People having high need for achievement are more likely to succeed as entrepreneurs.

According to McClelland, individuals with high need achievement will not be motivated by monetary incentives but that monetary rewards will constitute a symbol of achievement for them. Similarly, they are also not interested much for social recognition or prestige but their ultimate goal is personal accomplishment. That is why McClelland suggests that in order to raise the level of achievement motivation, parents should set high standards for their children.

Critical Evaluation:

Research studies on the psychological roots of entrepreneurship reveal that high achievement orientation ensures the success of entrepreneurs. But the empirical tools of concept used by McClelland are found to be highly suspect and one wonders how many of the individuals who are judged to have high n-achievement could succeed in utilising it in practice in the present-day developing countries unless strengthened by other reinforcing circumstances.

At the same time, empirical investigations also need the following:

- (i) It is necessary to create a climate (especially in educational institutions at various levels) to enable the children to grow to become individuals with high n-achievement.
- (ii) It is possible to improve the performance of existing entrepreneurs through imparting proper training and education.

Theory # 3. Status Withdrawal Theory:

E. Hagen attempted to formulate a theory of social change. The theory of social change explains that when members of some social groups feel that their values and status are not respected by the society, they turn to innovation to get the respect of the society. According to Hagen, entrepreneurship is a function of status withdrawal. This theory provides that a class which lost its previous prestige or a minority group tends to show aggressive entrepreneurial drive.

Hagen postulates four types of events which can produce status withdrawal:

- (i) Displacement of a traditional elite group from its previous status by another traditional group by physical force.
- (ii) Denigration of values, symbols through some change in the attitude of superior group.
- (iii) Inconsistency of static symbol with a changing distribution of economic power and.

(iv) Non-acceptance of expected status on migration to a new society.

Hagen further opined that creative innovation or change is the basic feature of economic growth. He describes an entrepreneur as a creative problem shooter interested in things in the practical and technological realm. Such type of individual feels a sense of increased pleasure when facing a problem and tolerates disorder without discomfort.

In traditional societies, positions of authority are granted on the basis of status, rather than individual ability. That is why, Hagen visualised an innovative personality.

There are four responses which assess the personality-

(i) Retreatist – One who combines to work in the society but remains indifferent to his work and position.

(ii) Ritualist – One who adopts a kind of defensive behaviour and acts in the ways accepted and approved in his society but with no hopes of improving his position.

(iii) Reformist- One who foments a rebellion and attempts to establish a new society?

(iv) Innovator- A creative individual who is likely to be an entrepreneur.

Innovation requires creativity and such creative individuals cause economic growth. In practice creative personalities emerge when the members of some social groups experience the withdrawal of status respect. Whenever there is any withdrawal of status respect, it would give rise to innovation—a creative individual who is likely to be an entrepreneur.

Critical Evaluation:

The theory acts to distinguish between entrepreneurship and intra-preneurship. There are different factors within the organisation which motivate the executives and professionals to do some innovative behaviour leading to new products and services. Actually, they are not governed by status withdrawal.

The theory only suggests that the people, who had enjoyed social standing at some stage in their histories fall into a retreatist phase and with an urge to regain that lost status emerge as entrepreneurial personality. The theory also presupposes a long term perspective for entrepreneurial growth about three to five generations for the emergence of entrepreneurship.

But actually it does not happen. In Most places, first generation entrepreneurs are quite successful in their entrepreneurial behaviour.

Theory # 4. Theory of Social Change:

It was Max Weber who first of all took the stand that entrepreneurial growth was dependent upon ethical value system of the society concerned. The central figure of the Weber's theory of social change consists in his treatment of the protestant ethic and the spirit of capitalism. Moreover, this theory provides an analysis of religion and its impact on entrepreneurial culture.

Max Weber opined that the spirit of rapid industrial growth depends upon a rationalised technology, acquisition of money and its rational use for productivity and multiplication of money. These elements of industrial growth depend upon a specific value orientation of individuals i.e., the tendency of acquisition and rational attitude towards action which are generated by ethical values.

Weber analysed his theoretical formulation by the relationship that he found between protestant ethic and the spirit of capitalism. He found his thesis true about other communities also, e.g., Hindu, Jain and Juda. He held that Protestants progressed fast in bringing capitalism because their ethical value system provided them with rational economic attitude, while the Jews and Jains failed to develop industrial capitalism because of their value of 'Pariha' (the restriction on having any contact with other communities).

According to this theory, driving entrepreneurial energies are generated by the adoption of exogenously supplied religious beliefs. It is these beliefs which produce intensive exertion in occupational persecutes, the systematic ordering of means to ends and the accumulation of assets.

For people who believe in this belief (Protestant ethic] hard-work in their walk of life is not only to enable them to have their worldly desires met but also to have their spiritual needs satisfied. Thus, in the Weberian system, the motivating force for entrepreneurial activity is provided by Calvinist ethic irrespective of the cultural background, personality type of the individual and the social environment to which he lives.

Critical Evaluation:

The theory of social change propounded by Max Weber is based on the invalid assumptions. So expected results are not valid in all cases.

These assumptions are as follows:

- (i) There is a single system of Hindu value.
- (ii) The Indian community internalised those values and translated them in to day to day behaviour and
- (iii) These values remained immune to and insulated against external pressures and change. The studies further show that Hinduism is not averse to the spirit of capitalism and to adventurous spirit. The Hinduism has contributed a lot in entrepreneurship development in India which is based on capitalism.

Theory # 5. Theory of Social Behaviour:

Kunkel presents a behavioural model of entrepreneurship. Supply of entrepreneurs is a function of social, political and economic structure. Behavioural model concerned with the overtly expressed activities of individuals and their relations to the previous and present surroundings, social structures and physical conditions.

According to Kunkel, Individuals perform various activities of which some are accepted by the society while others are not. The accepted are rewarded. The rewards act as reinforcing

stimulus increasing the probability of repeating that behaviour pattern. This pattern of social behaviour is entrepreneurial behaviour. The supply of entrepreneurship depends upon four structures found in a society.

That are as follows:

(i) Limitation Structure – The society limits specific activities and this limitation structure affects all the members (including entrepreneurs) of a society.

(ii) Demand Structure- Material rewards are necessary to lay the foundation for future social gains. Moreover, behaviour of people can be made entrepreneurial by manipulating certain selected components of the demand structure.

(iii) Opportunity Structure – It consists of the availability of capital, management and technological skills, information concerning production methods, labour and markets.

(iv) Labour Structure – It is concerned with the supply of competent and willing labour. The supply of labour is governed by several factors such as available alternative means of livelihood, traditionalism and expectations of life.

Critical Evaluation:

The theory assumes the ideal structures for the supply of entrepreneurs. But, generally, there is discrepancy between objectives, structures and the actual incidence of entrepreneurs. It is due to the fact that there are inadequate or incorrect perceptions attached with these perceptions. In practice, entrepreneurship is also governed by the specific combinations of circumstances which are generally not available in the environment.

Theory # 6. Theory of Leadership:

According to Hoselitz, entrepreneurship is a function of managerial skills and leadership. Business also requires finance but that is of secondary importance. He further explains that a person who is to become an industrial entrepreneur must have more than the drive to earn profits and amass wealth.

In this process, he has to show his ability to lead and manage. In business, there are generally three types of leadership—merchant money lenders, managers and entrepreneurs. In practice, money lenders are market oriented and managers are authority oriented. But entrepreneurs have in addition to these a production orientation.

The merchant money lenders deal in goods/services which is generally acceptable to everyone. However, an entrepreneur creates his own commodity and its acceptability is uncertain. Therefore, the entrepreneur assumes more risk as compared to a trader or a money lender.

In this context, it is important to note that making profit is not enough to succeed in entrepreneurship. Hoselitz opined that entrepreneurship can develop in a society where its culture permits a variety of choices and where social processes are not rigid. The social conditions should ensure the development of enterprise-oriented personalities.

Hoselitz emphasised the role of culturally marginal groups like Jews and Greeks in Medieval Europe and the Lebanese in West Africa, the Chinese in South Asia, the Indians in West Africa in promoting economic development.

Making use of the work of Stonequist and Park, Hoselitz formulated the hypothesis that marginal men, because of their ambiguous position from a cultural or social stand point, are peculiarly suited to make creative adjustments in situations of change and in the course of this adjustment process too, they are able to develop genuine innovations in social behaviour.

Critical Evaluation:

It is quite true that marginal men or groups enjoying an ambiguous culture and social position having no bondage of tradition to inhibit them from entrepreneurship development. But there are certain economic and political factors also which encourage the people to initiate entrepreneurial behaviour.

For example, Governments are trying to encourage first generation entrepreneurs by offering them various types of incentives and subsidies. Potential entrepreneurs are also opting for enterprise development without cringe for social or cultural restrictions.

Theory # 7. Theory of Model Personality:

The theory of Cochran is a sociological theory of entrepreneurial supply. Cochran emphasises cultural values, role expectations and social sanctions as the key elements that determine the supply of entrepreneurs. According to him, an entrepreneur is neither a super normal individual nor a deviant person but represents a society's model personality.

His performance is influenced by three factors:

- (i) His own attitudes towards his occupation.
- (ii) The role expectations held by sanctioning groups and
- (iii) The operational requirements of the job. In this context, society's values are the most important determinant of the attitudes and role expectations.

Critical Evaluation:

The theory deals with only social factors. Profit is the most important factor for encouraging entrepreneur to assume risky behaviour. Even need for achievement starts from profit making process. It is implied in need for achievement process. Besides, entrepreneur is also expected to assume managerial functions. But theory fails to incorporate all these requirements.

Theory # 8. Theory of Systematic Innovation:

Prof. Drucker has developed the theory of systematic innovation. According to him "Systematic innovation consists in the purposeful and organised search for changes and in the systematic analysis of the opportunities such changes might offer for economic or social innovation." Specifically, systematic innovation means seven sources for innovative opportunity.

The first four sources lie within the enterprise, whether business or public service institution, or within an industry or service sector. They are therefore visible primarily to people within that industry or service sector. They are basically symptoms. But they are highly reliable indicators of changes that have already happened or can be made to happen with little effort.

These four source areas are:

- (i) The unexpected—the unexpected success, the unexpected failure, the unexpected outside event;
- (ii) The incongruity—between reality as it actually is and reality as it is assumed to be or as it ought to be;
- (iii) Innovation based on process need;
- (iv) Changes in industry structure or market structure that catch every one unawares.

The second set of sources for innovative opportunity, a set of three involves changes outside the enterprise of industry-

- (i) Demographics (Population changes);
- (ii) Changes in perception, mood and meaning;
- (iii) New knowledge, both scientific and non-scientific.

Prof. Drucker, further remarked that the lines between these seven sources areas of innovative opportunities are blurred, and there is considerable overlap between them. They can be likened to seven windows each on a different side of the same building. Each window shows some features that can also be seen from the window on either side of it. But the view from the centre of each is distinct and different.

Critical Evaluation:

The theory of systematic innovation is quite comprehensive one. The entrepreneur is required to identify different sources of change. Thereafter, he is expected to coordinate these changes with the opportunities available in the environment. But the most important problem attached with this theory is the question of reliability and predictability of seven sources.

For example, new scientific knowledge is not the most reliable or most predictable source of successful innovations. However, theory tries to provide a comprehensive framework to the entrepreneurship.

Thus, on the basis of above theories, we can say that entrepreneurship is a multidisciplinary area. Actually, entrepreneurship is governed by human factor living in an ever-changing society pursuing simultaneously economic, social and psychological objectives. So unless a theory of entrepreneurship is woven into sociological, cultural, psychological, political and managerial fibre, it cannot give a sense of economic web.

2 Major Theories: Discovery Theory and Creation Theory (With Assumptions)

In spite of several attempts by various scholars, there is no generally accepted theory of entrepreneurship. There are different theories of entrepreneurship, based on the assumptions of various management experts. In the words of Gartner, “We in the field of entrepreneurship are unaware of the assumptions that we make, in our theoretical perspectives.”

The two theories of entrepreneurship are as follows:

1. Discovery Theory:

It includes Individual/Opportunity (I/O) nexus view, which lays emphasis on the identification, existence, and exploitation of opportunities and their influence of individuals. The individuals and the opportunities have influence on each other. For example, an opportunity comes into existence only when an individual identifies it, simultaneously an individual takes up the entrepreneurial activity because of the existing opportunity.

This theory approaches three assumptions in entrepreneurship, which are as follows:

- a. Opportunities have an objective component and their existence does not depend on whether the individual identifies these opportunities or not.
- b. Every individual is different from others. Therefore, different individual has different ability of recognizing opportunities. In addition, according to the discovery theory, individuals are always alert to the existing opportunities and this alertness is not a deliberate search, but the constant scanning of environment by individuals.
- c. Risk bearing is an essential part of the entrepreneurial process. The first and second assumptions of the discovery theory also support the risk bearing condition of entrepreneurship. As per these two assumptions, individuals can only discover and avail opportunities, but cannot create opportunities. They apply a unique combination of resources; means they do things differently to bring innovation.

As there is no certainty about the success of discovered opportunity, entrepreneurs bear risks by availing opportunity on the estimated probability of its success. Thus, the discovery theory states that opportunities are objectives, individuals are unique, and entrepreneurs are risk bearers.

2. Creation Theory:

Creation theory focuses on entrepreneurs and the creation of enterprises. Similar to the individual/opportunity nexus, the creation theory also approaches three assumptions in entrepreneurship.

The three assumptions are as follows:

- a. Opportunities are subjective in nature. The creation theory also emphasizes that opportunities are created through a series of decisions to exploit a potential opportunity. This

theory asserts that opportunities do not have an existence without the actions of entrepreneurs. The creation theory is opposite to I/O nexus.

The I/O model asserts that opportunities are discovered by scanning the business environment and analyzing the market and industry structure. On the other hand, the creation theory supports the view that opportunities are created by hypothesis testing and learning.

For example, consumer electronics organizations, such as Samsung, creates opportunities by developing new products, trying out those products in the market, finding out the products that are reasonably successful, and filtering the successful products and improving their marketability.

b. Opportunities are not recognized by individuals, but created by them. The creation theory suggests that entrepreneurship does not require differences in individuals, but differences in their decision making under uncertainty. According to the creation theory, an entrepreneur is someone, who organizes resources after evaluating the value of probable outcomes.

c. Individuals bear uncertainty not risk. The creation theory suggests that entrepreneurs create opportunities and act on them after estimating the probability of their success. Thus, bear uncertainty not risk.

Thus, the creative theory suggests that opportunities are subjective, individuals are ordinary, and entrepreneurs are uncertainty-bearers.

4 Important Theories: Cultural Theories, Economic Theories, Psychological Theories and Sociological Theories

“He loves practice without theory is like the sailor who boards ship without a rudder and compass and never knows where he may case.” – Leonardo Da Vincic

There are four factors of production i.e., land, labour, capital and organization. Organization is the coordinating factor that brings together the other three factors and entrepreneurship is the element that powers and strengthens the organization. Many of the economists believe that entrepreneurship is itself the fourth factors of production that is the most important in driving a successful economy.

Entrepreneurs are defined by their risk-taking abilities and their intentions to fill in the void because of the existing lack of knowledge about a product. According to them, the entrepreneur ventures are carried out where there is a gap in the development of a product. The entrepreneurs work to fill the gap by introducing something that increases the effectiveness of the already existing product.

The field of entrepreneurship continues to struggle with the development of a modern theory of entrepreneurship. In the past 20 years development of the current theories of entrepreneurship have centered on either opportunity recognition or the individual entrepreneur.

At the same time many theoretical insights have come from economics, including a rediscovery of the work of Schumpeter. However because there is a lack of clarity about the theoretical assumptions that entrepreneurship scholars use in their work, assumptions from

both individual opportunity recognition and economics, have been used as if they are interchangeable. This lack of theoretical distinction has hampered theory development in the field of entrepreneurship.

Throughout the theoretical history of entrepreneurship, scholars from multiple disciplines in the social sciences have grappled with a diverse set of interpretations and definitions to conceptualize this abstract idea. Entrepreneurship is an evolved thing. With the advancement of science and technology it has undergone metamorphosis change and emerged as a critical input for socio-economic development.

Nature of Entrepreneurship: What drives entrepreneurs?

The main features of entrepreneurship are as follows:

- (1) Economic activity – Entrepreneurship is primarily an economic function because it involves the creation and operation of enterprise. It is basically concerned with the production and distribution of goods and services.
- (2) Creative activity – Entrepreneurship is a creative response to changes in the environment. It involves innovation or introduction of something new and better. An entrepreneur is a change agent.
- (3) Purposeful activity – The entrepreneur creates and operates an enterprise to earn profits through satisfaction of customers, therefore, entrepreneurship is goal-oriented activity.
- (4) Function of risk-bearing – Risk is an inherent and inseparable element of entrepreneurship. An entrepreneur grants rent to the landlord, wages to employees, and interest to investors in the hope of earning more than the expenses. He assumes the uncertainty of future. In the pursuit of profit, there is every possibility of loss.
- (5) Organizing function – An entrepreneur brings together various factors of production co-ordination and control efforts of all the persons engaged in his enterprise. He harnesses land, labour, capital, and other resources for the benefit of mankind. Therefore, an entrepreneur is an organization builder.
- (6) Gap-filling function – The gap between human needs and the available products and services gives rise to entrepreneurship. An entrepreneur identifies this gap and takes necessary steps to fill the gap. He introduces new products and services, new methods of production or distribution, new source of inputs and new markets.
- (7) Dynamic function – Entrepreneurship is a dynamic function. Entrepreneurs thrive on change in the environment which brings about useful opportunities for business. Flexibility is the hallmark of a successful entrepreneur.
- (8) Innovative function – Entrepreneurship is an innovative function as it involves doing things in a new and better way. Innovation may take several forms a new product, a new source of raw materials, a new market, and a new method of production.

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