



Do Entrepreneurs Need Firms? A Contribution to a Missing Chapter in Austrian Economics

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In popular understanding, firms and entrepreneurs are closely related entities: an entrepreneur without a firm is difficult to imagine, and the fate of a firm usually hinges upon who takes the entrepreneurial lead. Curiously enough, economic theorizing has not taken much interest in the relationship between entrepreneurship and the firm as an organizational form. Theories focussing on the entrepreneurial element in the economy, in particular the contributions in the Austrian tradition, have paid hardly any attention to the role of the firm, while the various theories of the firm have largely disregarded the role of the entrepreneur (see Loasby (1991); an exception is Casson (1982) who, however, deals with the matter in a somewhat eclectic way). The entrepreneur has been a central figure in Austrian economics since Ludwig von Wieser's teachings at the beginning of the century (Streissler (1982)), a figure which was presented as something like a personification of the forces of change driving the economic process. Schumpeter (1912/1934) stylized Wieser's view into a theory of entrepreneurial capabilities with elitist connotations. von Mises (1949, pp. 252–256), by contrast, de-emphasized the personification, claiming that being alert in looking out for new possibilities and advantages is a general feature of "homo agens". For Mises, entrepreneurship is thus a talent which is, more or less, possessed by many.

It was left to Israel Kirzner (1973, 1989) to provide a complete elaboration of what Mises' entrepreneurial element means for the economic process. But, as the earlier writers in the Austrian tradition ignored the organizational form—the business enterprise—an entrepreneurial venture usually takes, Kirzner (1973, pp. 52–57), too, is reluctant to seriously consider the firm as an institution requiring an explanation of its own. He abstracts from the fact that entrepreneurial activity achieves coordination not only via markets but in many cases also, in a most essential way, through organizing a firm. Since firms obviously differ from markets, portraying the entrepreneurial role without including the relationship with the firm appears to be incomplete. It would be therefore worthwhile developing the missing Austrian approach to the firm—as was already suggested by O'Driscoll and Rizzo (1985, pp. 122–125)—but only very few attempts in that direction have so far been undertaken (Foss (1994), Foss (1998), Dulbecco and Garrouste (1998)).

In the Anglo Saxon tradition, particularly in Marshall's writings, the firm is a central unit of analysis (see Loasby (1990)). Yet, for Marshall, businessmen rather than entrepreneurs were involved with the firm—and this was not only a semantic difference. Marshall does not give much credit to the entrepreneurial element within the firm. One of the few exceptions is when he acknowledges that the vigor of the individuals is concerned with changes over their life cycles and that this possibly induces a similar life cycle pattern for their firms

(Marshall (1961, p. 316)). Even the minimal tribute paid to the entrepreneurial element was later omitted when the focus shifted to explaining the function of the firm. What originally started from a mere efficiency argument (Coase (1937)), developed into a theory increasingly preoccupied with an explanation of the organizational form of the firm as a device to check the potential opportunism of the firm's members. If the firm is viewed as a special organizational form designed to coordinate individual economic activities which is set up to economize on transaction costs, opportunism may no doubt threaten the gains in transaction costs (Williamson (1985)). Moreover, the threat of opportunism may discourage those asset specific investments of firm members which create potentially alienable quasi rents (Alchian and Woodward (1987)). However, important as the problem of finding effective measures of "governance" (Williamson (1979)) and "monitoring" (Alchian and Demsetz (1972)) may be for running the organization, such a perspective is a partial one only. It ignores the fact that, for a firm to become established in the first place, a conception of the business venture that is to be undertaken in the form of the firm is necessary—an indispensable entrepreneurial achievement.

For each firm that is set up there is a motive, that is the firm founder(s) must have some imaginings of what business to pursue and how. Such a business conception, no matter how elaborate, always rests on subjective conjectures about future events like the response of the markets, feasibility of inputs, price developments, actions of competitors, achievements of the firm members, etc. as Shackle (1972) has consistently emphasized. Some or all of these conjectures may turn out to be wrong, may challenge the underlying conceptions, and/or may demand modifications and learning. At any rate, the entrepreneurial imagination constituent to the birth of the firm, as well as to the later learning process, point to something that is difficult to come to terms with in an interpretation preoccupied with a transaction cost oriented approach. It is, therefore, not surprising that in the modern theory of the firm the entrepreneur has no role to play.¹

Thus, while the transaction costs approach disregards the role of entrepreneurial imagination in setting up the firm organization, the Austrian school recognizes the significance of entrepreneurial imagination without making the connection to the particular institutional conditions of the firm. What seems necessary in this situation is to bring the two aspects together and to show that considering them jointly can shed some new light on how the firm organization comes to be established and develops over time. The present paper makes an attempt in this direction. As will be argued in Section 1, in order to make progress it is necessary to engage in a brief exploration of some basic cognitive prerequisites and constraints of subjective economic action. On this basis, Section 2 introduces and discusses the notion of—cognitive—leadership and relates it to the entrepreneur's capacity to make the firm members adopt a common business conception. Section 3 elaborates on the market for entrepreneurship, actually portrayed as a competitive sorting process, which determines whose entrepreneurial conception is going to be pursued in firm organizations. Section 4

¹ Although there may be some differences with respect to the incentives, no distinction will be made here as to whether an entrepreneur is employed or self-employed. The latter question relates to the legal form of the firm, the question of who provides the liable funds, and who has a right to the residual claims. An extensive discussion of the related questions can be found in Casson (1982, chaps. 9–16). For the subjectivist approach developed below, which focusses on the cognitive features of entrepreneurship, these aspects are not of central importance.

briefly compares the entrepreneurial theory of the firm to the transaction cost approach to the theory of the firm. Section 5 offers some concluding remarks.

1. Subjective action and its social-cognitive underpinnings

A natural starting point for an Austrian approach to the firm is the subjective nature of the underlying business conception(s): conceiving a business venture is a necessary prerequisite for undertaking it in the organizational form of a firm. To induce the firm members to work for the entrepreneur's business conception, it has to be conveyed somehow. In both cases cognitive processes are at work and the particularities, and the constraints they impose, can be expected to cause some regularities in spite of all subjective variance that prevails otherwise. There is no doubt, for instance, that cognitive limitations—often alluded to in economics by the notion of bounded rationality—are relevant constraints on entrepreneurial activities. What enters the cognitive creation of a business conception is only a fraction of what could, in principle, be imagined to be possible series of choices that unfold into the future. Therefore, a brief reconstruction of the cognitive prerequisites and constraints of subjective action appears a promising task to start with.²

In fact, the individual agent's capacity to process and memorize information is limited. The limitations result from the constraints in man's short term, or working, memory (Anderson (1990, chap. 3)). A huge amount of sensory information is offered every moment of time by the nervous system in response to internal as well as external stimuli. The amount exceeds by far the working memory's capacity so some selection must take place. This selection is effected through discriminative attention processes which, in turn, rely on cognitive 'cues'. The latter screen sets of incoming information on an associative basis in terms of whether they fit existing patterns in memory. If familiar configurations cannot be easily identified in the incoming information, or if existing patterns cannot easily be extended to encompass it, the information is ignored. Otherwise attention is aroused to an extent that depends on whether the particular information is recognized as relating to earlier rewarding—or aversive—experience, i.e., on whether a significant preference or aversion can be associated with it.

The cues instrumental in memorizing patterns and identifying incoming information are normally organized into larger and more complex systems called 'frames'. Frames allow knowledge to be represented in a meaningful way (cf. Anderson (1990, chap. 5)). They support classificatory activities and often encapsulate information on cause-effect relationships. Indeed, the huge associative capacity of human long term memory is able to create, from a limited number of probably genetically coded cues, longer and longer associative chains with increasingly more complex sets of frames. The development starts in

²As is well known, in the Austrian school opinions are divided about such an extension. Accepting the (probably unnecessarily restrictive) *definition* of economics chosen by von Mises (1949, pp. 38–41), Israel Kirzner has always refrained from entering neighboring fields. However, it may be claimed that an attempt at increasing the empirical content of the theory of the entrepreneurial element is difficult to achieve without taking recourse to some 'psychological' hypotheses on what entrepreneurial capabilities are and what impact they have on the subjective sphere (see Witt (1989)).

individual socialization, in the learning of language, and in the identification of meaning, and extends far beyond these early phases into a lifelong process. As a result, the human mind always selectively utilizes information and 'frames' it within already existing interpretation patterns. This is no less true for the level of deliberate reasoning and induces here selective, and sometimes fairly rigid, mental conceptions.

Although subjective in nature, the individual's cognitive development just outlined is molded in social processes (Bandura (1986, chap. 2)). This point is usually neglected in the debate on bounded rationality, and it will turn out to have important bearings on the later considerations. Communication, particularly of the non-formal and often one-sided kind made available through socializing with others, enables people to observe, and compare, the behavior of other agents. The more frequent and intense the latter observations are, the better implicit representations of subjective knowledge—often labeled 'tacit' knowledge—can be grasped and acquired through imitation. Indeed, socializing with others and unconscious imitation of certain features of their behavior tend to induce cognitive commonalities: socially shared interpretation patterns and frames as well as common tacit knowledge of facts, hypotheses, practices, and skills. Often this also includes socially shared knowledge of rewarding (or aversive) instances, i.e., of the corresponding valuations. Furthermore, intense communication is usually subject to a spontaneous 'agenda setting' effect which modifies, in a self-reinforcing way which is similar for all participants, the frequency with which particular information is (at the expense of potentially rival information) exchanged and attracts attention.

In spite of all the subjective diversity that results from each individual's unique cognitive history, tacit cognitive commonalities are thus likely to occur among intensely communicating agents with respect to both the content of action related knowledge and to the way in which it is framed. To put it differently, intense communication tends to induce similarities in which alternatives of action the agents involved selectively perceive as being feasible and in what they disregard. (The fact that, due to their selective information processing, potential choices go unnoticed is normally not recognized by the agents, because the cognitive system that processes some information cannot at the same time reflect on how that information is processed.) A particular kind of knowledge subject to the social learning processes outlined is knowledge of how to behave in social interactions. Patterns of such behavior regularly displayed by some person(s) may gain the status of "models of behavior" (cf. Bandura (1986, chap. 2)). Their significance may lie in the vicarious nature of the fate of such "models". Since, in intensely communicating groups, the members' observational learning tends to focus on much the same models, the learning outcome is likely to be correlated. New group members coming in can intuitively grasp the behavioral regularity of prevailing models and their contingencies and consequences, in fact, the models may be inferred as representing a tacit 'rule of how to act'. Once established as a rule, people may feel confirmed in their biased, selective views which have led to the emergence of the social model of behavior.

Personal experiences which deviate from unquestioned tacit knowledge and social models can, of course, challenge the cognitive commonalities and lead to individualized learning. Whether those experiences result from ambiguities or misconceptions in associating meaning with incoming information, from reflection and inventive thinking, or simply from

an accidental discovery of choices not perceived earlier, the individuals may in any case create, and experiment with, novel actions. This, in turn, may give rise to a re-framing of action knowledge and to attitudes as well as social interactions which diverge from prevailing social models of behavior. Indeed, this is an important part of explaining the causes of change and, as will be shown later, the phenomenon poses a persistent challenge to firms. If individually discovered new action knowledge is indeed put to test, it is likely to be seen by others as a deviation. Such an event and, in particular, its consequences are likely to arouse considerable attention. The innovator's observed vicarious success or failure allows the other agents to assess their current behavior in the light of the new opportunities without having to experiment themselves. As long as the group members at least roughly agree in their appraisal of which outcomes are more or less preferable, the innovator's vicarious reward or loss tends to induce or inhibit corresponding behavior adjustments by imitation (Bandura (1986, chap. 7)). Social learning thus strengthens or weakens the tacit constraints on what is perceived as the choice set. The decisive question is whether behavior which deviates from the social models implied by those constraints is observed to lead to rewarding or penalizing consequences.

2. Entrepreneurship as cognitive leadership

Cognitive frames determine how people selectively perceive and interpret information, including information about feasible actions and choices. The way in which these cognitive frames emerge and change over time is influenced by communication processes with the social environment which endow people with tacit knowledge, socially shared interpretation patterns, and social models of behavior. Cognitive frames thus become an important source of commonalities that may limit the subjective variance in the perception of choices. This is of particular interest in the present context. The firm organization is an institutional setting of interactions which assigns certain individuals a position where they get a chance to shape the communication processes and thus exert an influence on the collective outcome. Indeed, it will be claimed here that this fact is an important reason firms, as organizations, can achieve internal consistency and co-ordination of individual efforts. To explain this it is useful to briefly reflect, in the light of the previous section, on the nature of business conceptions and their role in a firm's internal communication process.

Imagine an entrepreneur who has just founded a firm and who hires personnel and other resources. (Analogous reasoning applies to existing business when new ideas are introduced by employees who are in an entrepreneurial position.) Any such venture, it has been argued, is based on some initial notions of what can be undertaken, for what purpose, and how. Because they rely on the entrepreneur's intuition and tacit knowledge, those notions are subjective in nature. Over time they develop into more or less complex business conceptions. Although business conceptions may inspire detailed plans and strategies, they are not themselves plans. Rather they represent interpretative frameworks which furnish a decision maker with a general orientation and a general associative basis for deriving action information. The general, and rather unspecific, character of the conceptions is necessary for the following reason.

The cognitive limitations mentioned earlier make it impossible to anticipate all possible business moves that unfold into the future. There is always some new up-coming information about non-anticipated events and consequences of own actions which must be classified, interpreted, and assessed with respect to possible implications for the business. To put it differently, a business conception has the features of a cognitive frame that helps interpret what is going on in the light of the firm's overall goals and associate appropriate actions with the state of affairs conceived. As cognitive frames, business conceptions are subject to bounded rationality as outlined in the previous section. For the firm as an organization with an internal division of labor the latter level is important. The entrepreneur's venture serves the purpose of jointly realizing a conception that (s)he is unable to realize by her/himself alone. Thus, the problem arises of transmitting that subjective conception. For the employees to be able to decide, within their respective fields of specialization, in a co-ordinated way consistent with the entrepreneur's business conception they must share that conception. (Indeed, the general, i.e., rather unspecific, nature of that cognitive framework is no less important for the employees' situational problem solving than it is for that of the entrepreneur.)

It is at this point that the capacity to shape the communication processes within the firm appropriately becomes a crucial condition for entrepreneurial success. As was explained above, frequent communication tends to induce socially shared interpretation patterns, tacit knowledge, and models of behavior. In particular, the informal communication which people cultivate when socializing with one another helps establish cognitive commonalities through imitation. Thus, wherever employees, whether just hired or already in the business, are supposed to acquire new conceptions it would be erroneous to assume that they could do this on the basis of mere instructions in a formal communication process. Devising organizational and administrative routines is not sufficient either for getting employees to the point where they adopt a business conception. It is socialization in informal communication processes within the firm that is a crucial medium for transmitting those conceptions. However, while the firm is an institutional set-up that provides the entrepreneur with the power to define the structure and the agenda of formal communications, there is much less of an institutional basis for gaining influence on the informal communication processes.

The agenda of formal communication can be determined as a matter of mandate and subordination and is thus easy to control. By contrast, the agenda of informal communication within the firm can hardly be controlled at all and is therefore open to rivalling cognitive frames and attitudes. What seems required for the entrepreneur to be able to seize the chance of influencing informal communications in a way that is advantageous to the propagation of her/his business conception is a particular skill: leadership within the firm. To explain this, imagine an agent who is capable of dominating the informal process of communication within a group. This means that the interpretation patterns, tacit knowledge, and social models (s)he implicitly propagates are imitated by the members of the group more often than those of others. An agent with such an influence is often said to take the lead socially, but what is actually required is to take the lead in shaping the cognitive commonalities within the group. This is the particular meaning of the notion of leadership used here.

Leadership in this sense has much to do with skills that help to win through in informal communication: eloquence, persuasiveness, patience and persistence, the capacity to gain

sympathy and confidence etc. However, at a given level of these skills, exercising leadership may be easier or harder to achieve depending on the quality and the appeal of a business conception. Its success or failure depend on the quality of the conception and these, in turn, affect the employees' material conditions (remuneration, fringe benefits, career options, working conditions). If this causes satisfaction (dissatisfaction) among the employees, the entrepreneur's leadership may benefit (suffer). The underlying processes have self-reinforcing features because of the selective attention processes at the level of the individual which tend to discriminate against cognitive patterns other than the leading ones. This holds, of course, with respect to whatever becomes dominant in the informal communication processes within the firm. Therefore, failure to prevent rival cognitive contents from tacitly taking the lead in the firm's informal communication, i.e., lack of leadership on the part of the entrepreneur, is likely to end up in a poor performance with respect to, or even the break down of, internal consistency and co-ordination of the firm's decision making.

3. Subjective entrepreneurial conceptions and their competitive sorting process

Before it comes to the actual testing of whether leadership skills suffice to induce the firm members to follow the entrepreneurial imaginations and to adopt the suggested business conception, another question must be decided: which business conceptions are indeed pursued up to the stage where they are turned into an enterprise and personnel and other resources are hired? Who is to assume the entrepreneur's position (whether employed or self-employed) and who that of the employee in non-entrepreneurial position? In economic theory the answer is often considered to be the outcome of a market for entrepreneurship. However, there is no such market in the literal sense of an interaction of supply and demand. Supply may abound: entrepreneurial imaginings can be developed by many people in large numbers—far more, in any case, than are actually observable in firms. Yet in absence of a demand side, at least with respect to self-employed entrepreneurs, there must be a different clearing process which sorts out, among the multitudinous imaginings, those which are indeed turned into ventures. By the same token, that process sorts people into those who will be giving and those who will be taking entrepreneurial visions—and it is the former who take the entrepreneurial role.

The clearing process can be imagined as follows (Witt (1987)). In principle, every agent who has developed a business conception can attempt to hire employees and/or other resources and thus become an entrepreneur and pursue the conception within a firm. However, in order to succeed in hiring resources, the agent must offer competitive wages. For this reason, prospective entrepreneurs usually develop some idea about what wages their business will be able to offer and how much income they may be able to earn (as an employed entrepreneur) or keep for themselves after paying the wages offered (as self-employed entrepreneur). Given the large number of conceptions and the many people developing them, it is quite likely that someone who considers hiring personnel can obtain an offer of work as an employee in a non-entrepreneurial position in someone else's venture. Thus, a straightforward comparison can be made not only between the non-pecuniary features of assuming either the entrepreneurial role or the employee role, but also between the pecuniary features.

The wage that can be earned by joining someone else's venture can be measured against the imagined income from running your own venture.

Thus, a contest between entrepreneurial projects arises from the mutual offers. People are provided with information that allows them to assess how promising their own business ideas are compared to those of others. The competitive process which sorts people into entrepreneurs and employees is the outcome of those comparisons. Abstracting from the idiosyncratic evaluations on the non-pecuniary side, the agent who can pay more than other agents would earn after they payed her/him is likely to find her/himself starting, or running, a firm. All comparisons of the profitability of entrepreneurial projects are, of course, based on subjective assessments which may turn out to be wrong. Consequently, the results of the sorting process are not necessarily stable. The original assessments are confirmed if the imagined entrepreneurial income and the pecuniary and non-pecuniary rewards offered to those who decide to become an employee can indeed be earned. Firms unable to create a flow of earnings which lives up to those expectations will not be around for long. To avoid that fate, a venture must be able to gain access to a sufficiently profitable market and the new entrepreneur must have sufficient leadership skills, though a limited trade-off between the two requirements may be possible.

Even if these conditions are met, some of the results of the sorting process may not be necessarily stable. The subjective opportunity costs of being hired for someone else's business—which are given by the entrepreneurial income that could possibly be earned by pursuing an own venture—can go up because of discoveries or innovations in the business conception relevant to an own venture. In such a case, an agent who has become an employee in a non-entrepreneurial position in a first sorting may feel induced to leave the firm and to set up something of her/his own. Steps in that direction will be renounced only if the firm is able to transfer the agent to a position in which (s)he can profitably be employed and pay a sufficiently increased wage. This may often only be possible if the agent can be entrusted with a position which makes use of her/his entrepreneurial capacity, perhaps by pursuing his own business idea within the existing firm. Otherwise such an agent—often already at managerial level—will break away and start an own firm. If her/his innovative ideas allow non-pecuniary rewards and wages to be offered that attract other employees into the emerging enterprise, the development can result in a real fissioning as sometimes occurs with firms in highly innovative industries (Ziegler (1985)).

The threat of fissioning increases a tendency towards wage differentiation which is implied already by the logic of the sorting process between entrepreneurs and employees. The wages earned by the employees in non-entrepreneurial positions can be expected to differ if these agents have differing opportunity costs of being hired. This is the case if they differ in entrepreneurial alertness, and if the employer is able to discriminate among the employees with respect to this. Where entrepreneurial alertness is demanded in varying degrees at several levels in the firm organization a sorting of employees to positions within the firms should take place according to logic described above. That sorting process should result in a structure of earnings within the firm which reflects the differences in entrepreneurial capacity among the employees. The more entrepreneurial alertness a position demands, the more of that trait should be possessed by the employee who fills the position and the higher the share of the firm's returns awarded to that employee should be.

4. Tempering the challenge of opportunism

A success condition for a firm stated in the previous section is that the entrepreneur must show sufficient leadership skills, in particular a capacity to successfully implement and enforce her/his business conception. Employees must be induced to actually comply with the entrepreneur's business conception so that it guides their decision making in the firm. Since business conceptions are similar to cognitive frames, this is a matter of social learning rather than formal instruction. If the entrepreneur fails in her/his endeavor, a problem turns up that has indeed been a major theme in the theory of the firm: the menace of an opportunistic, hidden pursuit of separate interests by the employees at the expense of the firm. As is well known, concern with deception by firm members motivates both the "monitoring" approach (Alchian and Demsetz (1972)) and the "governance" approach (Williamson (1979)) to the theory of the firm. Both interpret the organizational form 'firm' as an institutional device that has been created to prevent deception and to keep it in check. However, because they lack an understanding of the process of transmitting a business conception internal to the firm, these approaches take a one-sided view. They fail to acknowledge the crucial contingency of opportunism within the firm, i.e., compliance or non-compliance with the entrepreneur's business conception.

Since attention is highly selective and influenced by the current interpretation patterns, a persuasive business conception which is being adopted by an employee may distract her/his attention from existing non-compliance alternatives in a self-reinforcing manner. Hence, if the entrepreneur can dominate the informal communication process within the firm so that elements of her/his conception become tacit cognitive commonalities, the interpretation patterns shared by the firm members may involve them cognitively in the entrepreneur's endeavor. Making those problems their own may make it less likely that employees engage in figuring out paths leading them to opportunistic choices. In fact, this may be the reason successfully implemented business conceptions which leave room for initiative and creative activities—as in an innovative firm—are much less often faced with opportunism than the governance approach would have us believe. Moreover, commonalities emerging from social learning also include tacit social models of behavior. Leadership in the informal communication process may also mean success in launching a social model of 'commitment to the business conception' and in demonstrating its characteristic attitudes. If the model of conduct spreads throughout the firm by imitation and becomes representative, it can help to keep down opportunism. The reason is not necessarily any normative power that it may exert (which would have to be dealt with in a framework of interdependent preferences), but a cognitive effect: the simple fact that the employees by observing, among themselves, non-compliance and its potentially, individually rewarding consequences are not given wrong idea.³

The things cognitive entrepreneurial leadership can achieve, the formation of a set of tacitly shared social models (a corporate culture) and the implementation of a business

³Recent discussions on "corporate culture" in the management literature (e.g., Hofstede (1986)) may, contrasting with transaction cost oriented interpretations (e.g., Kreps (1990)), be comprehended as actually suggesting the devising and propagation of social models specific to a corporation with precisely the effect just mentioned.

conception with which employees comply, are fairly transient phenomena. Once the entrepreneurial effort and leadership fades, rival conceptions may gain a foothold and attitudes may change. As explained in Section 1, deviant private experiences of the employees threaten the authoritative effect of tacit cognitive commonalities and shared social models. The self-reinforcing features of the informal communication process tend to protect, within certain bounds, an established cognitive frame from those potential challenges. Once the domination of the communication process by the entrepreneurial business conception slackens beyond a critical point, however, a re-framing of the employees' interpretation patterns may become impossible to stop. In that case, individual behavior may well turn away from the previously shared social model to opportunism.

5. Conclusions

The neglect of the firm as the organizational form of an entrepreneurial venture has a tradition in Austrian economics. It may be traced back to a characteristic of the scientific community in the German language countries. There, economic theory (*Volkswirtschaftslehre*) and business economics (*Betriebswirtschaftslehre*) were institutionally segregated as early as at the turn of the century to a degree still unknown today in the Anglo Saxon world. As Lachmann once conjectured, Austrian writers therefore considered the organizational form of entrepreneurial activities to be a topic best left to their business economics fellows.

"In Germany '*Betriebswirtschaftslehre*' has been a well developed discipline since 1900; in the Anglo Saxon world this discipline does not exist. ('Business administration' is hardly the same—at best it is a part of it.) There is no English word for '*Betrieb*'. . . . The Austrians of the 'golden decade' (1904–1914) were entitled to believe that the '*Betrieb*' and everything related to it, such as the firm hierarchy, was not a part of their research agenda. In their circumstances, this was not an omission. Now things have changed through the transplantation of Austrian thought to the Anglo Saxon world, first by Mises and Hayek, then in a broad stream. I concede that today we need an Austrian theory of the firm, if only to enable us to be armed against the Alchian and Demsetz band—to put it no higher than this!"⁴

In line with this assessment the present paper has made some effort to fill the gap and to develop a subjectivist approach to the firm. The basic premise from which the considerations started was the insight that, underlying the creation of a firm, there are always some entrepreneurial imaginations about what business to do and how. It has been argued that of the many subjective imaginings of technological and commercial possibilities which may be developed by many people only a tiny fraction is actually turned into a venture in the form of a multi-person firm. Hence, a clearing process takes place which sorts people into two groups: agents who inspire others to follow their business conception and agents who do (or, in an opportunistic attitude, do not) get inspired. In the firm the former assume

⁴Translated from German from a letter from Ludwig M. Lachmann to the present author, dated New Years Day 1987.

the entrepreneurial position, the latter the position of non-entrepreneurial employees. The explanation of necessary or sufficient conditions for success in the competitive sorting process is closely related to another, equally important problem: how can the firm members be induced to follow the entrepreneurial business conception as a common device in their decision making within the firm? This question requires a thorough reconstruction of the cognitive foundations of a theory of entrepreneurship and the firm as it has been provided in the paper by elaborating the social implications of bounded rationality.

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