The Origins of Entrepreneurial Opportunities

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Abstract. Kirzner’s (1973) theory of entrepreneurship emphasizes the equilibrating role of entrepreneurship. When the market is not in equilibrium, profit opportunities exist, and entrepreneurs discover and act on these profit opportunities to equilibrate the market. Because Kirzner focuses on entrepreneurial actions when profit opportunities exist, and does not describe where they come from, one could imagine a fixed stock of profit opportunities that get used up as entrepreneurs discover them. But new profit opportunities are being created constantly. A taxonomy of the origins of entrepreneurial opportunities includes factors that disequilibrate the market, factors that enhance production possibilities, and most notably, opportunities created from previous acts of entrepreneurship. Entrepreneurial actions do not use up profit opportunities, but create them, and the critical role of entrepreneurship in the creation of new profit opportunities is emphasized. This line of reasoning leads directly to policy implications regarding the economic environment conducive to entrepreneurial discovery and the role of government in research and development. This paper enhances Kirzner’s theory of entrepreneurship by illustrating how entrepreneurship enlarges the stock of future entrepreneurial opportunities, and points to entrepreneurship as the engine of economic progress.

Key Words: entrepreneurship, economic growth, equilibrium, profit, research and development

JEL classification: D20, Production and Organizations, General.

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Entrepreneurship occurs when an individual acts to take advantage of a profit opportunity that presents itself in the economy. In its simplest form, the entrepreneur might notice that one person is willing to sell something for less than someone else is willing to pay for it, so the entrepreneur can act as a middle man, profiting from buying at the lower price and selling for more. The profit, which is the return to the entrepreneur’s alertness to the opportunity, was created entirely by the entrepreneur’s activity, because the sale would not have taken place without someone having noticed the profit opportunity. The entrepreneur’s activity benefits the buyer, the seller, and more generally, the entire economy. Furthermore, the entrepreneur’s profit signals potential suppliers and demanders about their market opportunities, and even signals other potential middlemen of the profit opportunity for facilitating exchanges. Eventually the ability to earn above-normal profits will be competed away, but only after those profits have served their role in signaling a way in which resources could be more efficiently allocated in the economy. Entrepreneurship is indispensable for economic progress, but entrepreneurial activity is possible only when profit opportunities are available to the entrepreneur. This paper discusses the ways in which those profit opportunities can arise in an economy.
The entrepreneurial process is often more complex than simply having an entrepreneur notice that something can be purchased from one party and sold at a profit to another. Two complicating factors are production and time. For example, the entrepreneur might conjecture that if several inputs are purchased today and combined in a production process that occurs over time to produce some new output, that output could be sold in the future for more than it costs to purchase the inputs today. Yet these complexities do not alter the fundamental nature of entrepreneurship. While entrepreneurial opportunities are more difficult to spot when they involve production and time, and while they also involve some uncertainty about the outcome, the essential entrepreneurial act is still the noticing and acting upon a profit opportunity. Kirzner (1973) has emphasized the role of entrepreneurship in equilibrating an economy and leading to a more efficient allocation of resources, but Kirzner’s model of entrepreneurship has focused on the behavior of entrepreneurs in response to profit opportunities. This paper discusses where those profit opportunities originate, thus making Kirzner’s model of entrepreneurship more complete.

If one views the economy as tending toward equilibrium, and accepts Kirzner’s entrepreneurs as the economic agents who act on profit opportunities that exist in disequilibrium in order to equilibrate the economy, then eventually all of those profit opportunities will be competed away, and the economy will remain in equilibrium. What produces the profit opportunities to begin with? This paper identifies three major categories of factors that create profit opportunities: (1) Factors that disequilibrate the market; (2) Factors that enhance production possibilities; and (3) Entrepreneurial activity that creates additional entrepreneurial possibilities. An analysis of each of these categories leads to the conclusion that by far the most significant cause of entrepreneurial opportunities is prior entrepreneurial activity. Entrepreneurship creates the opportunity for more entrepreneurship, which leads to economic progress. Entrepreneurship provides an important equilibrating function, but also is the crucial element in economic growth. After discussing the theoretical relationship between entrepreneurship and economic growth, the paper considers the institutional framework that is most conducive to entrepreneurship and growth.

**Entrepreneurship in Economic Models**

Paradoxically, while entrepreneurship has been becoming an increasingly important part of the economy in the twentieth century, it has been becoming increasingly less important as a part of economic theory. Entrepreneurship occurs when an individual notices and acts on a profit opportunity, but in the equilibrium models that dominate economics at the end of the twentieth century, all profit opportunities have already been exploited, meaning that there is no role for entrepreneurship in this type of model. To capture the role of entrepreneurship, economists must focus their attention on the process that leads individuals to seek profit opportunities, rather than on a state of equilibrium in which, by assumption, no profit opportunities exist. The benefits of studying the process by which economies adjust while moving toward equilibrium should be obvious, because even the staunchest equilibrium theorist will agree that while economic forces always pull the economy toward an equilibrium, equilibrium is a moving target that the economy always approaches but never reaches. It makes sense, then, to devote attention to the