The Tangible and Intangible Institutions of Non-market Entrepreneurship: Objective and Subjective Opportunities in Public Sector and Nonprofit Entrepreneurship

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Introduction

The Popper-Kuhn controversy has been described as a classic debate between rationalism and relativism (Gupta, 1993). Karl Popper is an archetypal rationalist, one who believes in objective standards of truth. "I should like just to indicate briefly why I am not a relativist," Popper (1970) writes. "I do believe in 'absolute' or 'objective' truth, in Tarski's sense (although I am not an 'absolutist' in the sense of thinking that I, or anybody else, has truth in his pocket)" (p. 56). Popper's concept of verisimilitude lies at the heart of his objectivism. Popper defines "verisimilitude" in *Objective Knowledge* (1989) as "truthlikeness": "The verisimilitude of a statement will be explained as *increasing with its truth content* and *decreasing with its falsity content*" (Popper, 1989, p. 48). "The aim [of science]," he declares, "is to find theories which, in turn, in the light of the critical discussion, get nearer to the truth. Thus the aim is to increase of the truth-content of our theories" (Popper, 1970). By contrast, Thomas Kuhn is labeled as the archetypal relativist, one who believes that "all standards of knowledge are locally defined with respect to the practices and norms of a community of experts (usually scientists) at a given period of time," as articulated by Professor Rothbart once again. A sociology of knowledge underlies the Kuhn's subjectivist position. "Whatever scientific progress may be, we must account for it by examining the nature of the scientific group, discovering what it values, what it tolerates, and what it disdains" (Kuhn, 1970). Popper contrasts himself with Kuhn when he writes that his epistemological position is "Truth as correspondence with the facts," whereas the position of Kuhn and others like-minded relativists is "Truth as property of our state of mind – or knowledge or belief" (Popper, 1985b, p. 187). The Popper-Kuhn controversy did not originate the rationalist-relativism debate over objective and subjective truth, nor did it end it.

In this paper, we revisit the rationalism-relativism debate over objective and subjective truth in the novel, if not strange, form of the institutional forces that influence entrepreneurship in the for-profit, public and nonprofit sectors. (And we would not mind instigating a bit of controversy as well.) Previous theoretical research has outlined the relationship between entrepreneurship and institutions generally (Boettke & Coyne, 2006; Hwang & Powell, 2005), political entrepreneurship and political institutions (Sheingate, 2003), and entrepreneurship in all three sectors (Frank, Shockley, & Stough, 2004). Stated perhaps too simplistically, this small but growing body literature suggests that institutions guide entrepreneurial behavior like they do all economic behavior. "The underlying logic of the connection between institutions and entrepreneurial behavior," Boettke and Coyne (2006) write, "is the realization that institutions, or the rules of the game, provide a framework that guides activity, removes uncertainty, and makes the costs of action and facilitates the coordination of knowledge dispersed throughout society" (p. 120). The primary means by which institutions guide behavior is structuring the opportunities that entrepreneurs identify and act on. As Douglass North (1990) asserts, "Institutions, together with the standard constraints of economic theory, determine the opportunities in society. Organizations are created to take advantage of those opportunities, and, as organizations evolve, they alter the institutions" (p. 7).[1] In this paper, we are motivated to find out if there is anything else that can be said about the institutional forces on entrepreneurship in the different sectors.

We believe that there is something more that can be said specifically about how institutions structure opportunities in the three sectors with the terminology of Popperian rationalism and Kuhnian relativism. In this paper, we make the proposition that there are at least two distinct ways to interpret the relationship between institutions and entrepreneurship, two characterizations of the nature of institutions, and two types of entrepreneurial opportunities that institutions structure. Corresponding to Kuhnian relativism, *intangible* institutions—such as "rules of the game," practices, patterns, and roles (Baumol, 1990; Kasper & Streit, 1998)—structure *subjective* entrepreneurial

[1] Also see Yu (1999) for entrepreneurs needing the firm "as a coordinating institution" (p. 30).

opportunities, or ones that are perceived but may or may not materially exist and, regardless of their existential status, as background institutions are not involved in daily transactions and exchanges. Corresponding to Popperian rationalism, *tangible* institutions that we argue are characteristic of new institutional economics—constitutions, bureaucracies, cost structures, organizatioanl hierarchies, procedures, and laws (Furubotn & Richter, 2000; North, 1990; Williamson, 1975, 1985)—structure *objective* entrepreneurial opportunities that are materially bounded and are involved in daily transactions and exchanges. Moreover, we also make the proposition that each of the three sectors associates most closely with one of the two institution-opportunity nexuses. Intangible institutions and subjective opportunities predominate in the for-profit and nonprofit sectors while material institutions and objective institutions predominate in the public sector.

Our propositions are grounded in the intuition that there are more tangible institutions in the public sector than there are in the for-profit and nonprofit sectors in modern liberal democracies (this intuition of course should be empirically verified). While our propositions could be construed as contravening March and Olsen's (1984; 1989; 1995; 1996), we do not believe that this is necessarily the case and it certainly is not our intention. For example, we readily accept March and Olsen's (1989) observation that "although rules bring order, we see sets of rules as potentially rich in conflict, contradiction, and ambiguity, and thus as producing deviation as well as conformity, variability, and standardization" (p. 38). This is not a recidivist tract that seeks to return to the "old" institutionalist perspective or the logic of consequences. We leave plenty of room for the logic of appropriateness. Instead, we argue that the predominance of tangible institutions in the public sector leave comparatively less "conflict, contradiction, and ambiguity" in entrepreneurial opportunity than does the predominance of more intangible institutions in the for-profit and non-profit perspective.

We begin our analysis by examining what might be called the "classical" and contemporary conceptions of the relationship between institutions and entrepreneurship. We look at the work the Israel Kirzner and Joseph Schumpeter (i.e., the classical conceptions) as well as structure and agency theories and new institutional economics (i.e., the contemporary conceptions). The classical and contemporary conceptions reveal at least two distinct ways of interpreting the relationship between institutions and entrepreneurship, two characterizations of the nature of institutions, and two types of entrepreneurial opportunities that institutions structure. Then, in light of the results of our first-level analysis, we then look more specifically at the institutionalist forces in the public and nonprofit entrepreneurship and consider which of the institution-opportunity nexuses predominates in each sector.

Entrepreneurship and Institutions: Classical and Contemporary Conceptions

The last great theorists of entrepreneurship are Israel Kirzner and Joseph Schumpeter. Kirzner and Schumpeter seem to have outlasted their prior theorists (see Formaini, 2001) and seemingly every contemporary theorist grounded in the history of entrepreneurship theory references one or both of them. In both Kirznerian and Schumpeterian theories of entrepreneurship the importance of institutions is not immediately apparent. A deeper consideration of their theories of entrepreneurship, however, reveals precisely the distinction between the subjective and objective opportunities that we seek.

Kirznerian entrepreneurship always emphasizes "entrepreneurial discovery."

> The essence of entrepreneurship consists in seeing through the fog created by the uncertainty of the future. When the Misesian human agent acts, he is determining what indeed he 'sees' in the murky future. He is inspired by the prospective pure-profitability of seeing the future more correctly than others do. (Kirzner, 1997b, p. 51)

While it is difficult to ascertain institutional forces amid the barrage of metaphors, there is a strong presence of implied institutions in Kirzner's thought. Institutions are implied in "equilibration" (i.e., movement toward an equilibrium state), which Kirzner describes as the *effect* of entrepreneurial discovery. Kirzner identifies entrepreneurship as the central feature in understanding the market as a dynamic process, not as a static state. "For me," Kirzner (1973) writes, "the changes the entrepreneur initiates are always toward the hypothetical state of equilibrium…" (p. 73). Consequently, he "…finds entrepreneurship incompatible with the equilibrium state, but compatible with, and indeed essential for, the notion of the equilibration process" (Kirzner, 1992a, p. 7). (See also Kirzner, 1997a, p. 62; Vaughn, 1994, p. 152). It can be argued that the market process would not equilibrate (but rather would be random) without a persistent set of institutions within which entrepreneurial discovery occurs.

In Kirznerian entrepreneurship, the implied institutions allow for only subjective profit opportunities to be *perceived*; the opportunities may or may not be real. Equilibration is central to Kirznerian entrepreneurship as it reflects the pursuit of profit opportunities. Profitable opportunities arise from prior human error only when the market is in disequilibrium: "In equilibrium there is no room for the entrepreneur. When the decisions of all market participants dovetail completely…and no possibility exists for any altered plans that would be simultaneously preferred by the relevant participants, there is nothing left for the entrepreneur to do" (Kirzner, 1973, p. 26). Without basic market institutions that support the emergence of profit opportunities (e.g., property rights, rule of law), they would not be perceptible. Harper (1998) outlines the core institutional conditions affecting entrepreneurial activity while providing incentives to exploit profit opportunities. In brief, these primary conditions are freedom and liberty, rule of law, certainty of law, private property, freedom of contract, and freedom of entrepreneurial choice. Without these conditions, entrepreneurship will likely fail to flourish and entrepreneurs will lack the incentives to create and discover profit opportunities.

Economists define institutions as the rules of the game in society or the "humanly devised constraints that shape human interaction" (North, 1990, p. 3). Institutions allow people to interact and transact in a market because of the establishment of trust and the reduction of uncertainty. These constraints on people's choices can be formal in that they are written down, or they can be informal, tacit rules that cannot be articulated (Harper, 1998). Additionally, Harper notes in his analysis of North (1981) that the institutional framework of society "comprises constitutional rules, operating rules, and normative behavioral codes" (Harper, 1998, p. 242). Institutions consist of governing laws, contracts, property rights, and other legal and operational codes that provide predictability. In terms of a dynamic market process, institutions are essential for entrepreneurs to act without entering the completely unknown. As Kasper and Streit (1998) note, "human interaction in the economy depends greatly on fairly regular patterns on which people may rely" (Kasper & Streit, 1998, p. 19). However, they are not an essential part of daily transactions and regular exchanges. Instead, they lurk in the background of a mixed market economy, and for this reason we consider them *intangible institutions*.

Why are these entrepreneurial opportunities structured by intangible institutions subjective? "In the market system the existence of opportunities is signaled by profit opportunities in the form of price differentials. Now signals may not always be seen but the kernel of market theory is that a *tendency* exists for them to be seen" (Kirzner, 1979, p. 116, italics in the original). These basic market institutions, however, support ethereal indicators of market process, namely, price signals that facilitate exchange. The market equilibrates solely as the result of ethereal indicators profit opportunities structured by market institutions. "The market process, then, consists of those changes that express the sequence of discoveries that follow the initial ignorance that constituted the disequilibrium state" (Kirzner, 1992b, p. 44). Thus, according to Kirznerian entrepreneurship, when the entrepreneur's alertness identifies a profitable opportunity within a set of market institutions, the equilibration process is triggered and the market process is engaged. But all of this is occurring in the in the minds of the market participants. The traces of market exchanges and transactions are merely instantiations of the subjective thought processes. The implied set of intangible institutions in Kirznerian entrepreneurial discovery allow for no more and no less.

The implicit institutions structuring subjective opportunities in Kirznerian entrepreneurship suggests an affinity with issues of structure and agency. Giddens (1984) conceptualizes his structuration theory around *agency*, which "refers not to the intentions of people have in doing things but to their capability of doing those things in the first place" (p. 9), and *structures*, which "refers, in social analysis, to the structuring properties allowing the 'binding' of time-space in social systems (p. 17). Not only do agency and structures—or resources and schema, as Sewell (1992) suggests—correspond quite well to the entrepreneur and institutions, but this "duality of structure" also accommodates something like entrepreneurial opportunities as "the structural properties of social systems are both medium and outcome of the practices they recursively organize" (p. 25).[2] In fact, the affinity between entrepreneurship and structuration theory noticed by Sarason, Dean, and Dillard (2006), who explicitly applied structuration theory to entrepreneurship. "We argue that entrepreneurs both create and are created by the process of entrepreneurship and therefore can be viewed as a duality" (p. 292). The recursivity required by structuration theory, that is, the process of entrepreneur creating the opportunity and at the same time the opportunity creating him or her, demonstrates the subjective nature of opportunities structured by intangible institutions. Kirznerian entrepreneurs depend on intangible institutions to be "guarantors of coordination" (Vaughn, 1994, p. 144), which itself indicates that they operate in the realm of relativity and subjectivity.

While Schumpeter's and Kirzner's theories of entrepreneurship share many complementary components (see Boudreaux, 1994; Choi, 1995; Kirzner, 1999), they ultimately differ in their

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[2] Also see Emirbayer and Mische's (1998) integration of agency with temporality, which is crucial in establishing the link between entrepreneurship and agency.

institution-opportunity nexus they each provide. In contrast to Kirznerian entrepreneurs as "guarantors of coordination," Schumpeterian entrepreneurs are "disruptors of life" (Vaughn, 1994, p. 144), which itself in turn insinuates that they operate in the realm of objectivity. In *The Theory of Economic Development* (1934/2002), Schumpeter locates the primary agent of economic change and development in a healthy market economy in entrepreneurship. "Development," he writes, "is spontaneous and discontinuous change in the channels of flow, disturbance of equilibrium, which forever alters and displaces the equilibrium state previously existing" (p. 64). Schumpeterian entrepreneurship operates not by price signals but by new combinations of existing gods or services. It is the carrying out of new combinations in the form of introducing a new good or method of production, opening of a new market, identifying a new source of supply of raw materials or half-manufactured goods, or carrying out of the new organisation of any industry (p. 66). "All of these cases [of new combinations]," Schumpeter (1926/2003) writes, "are cases of carrying out a different use of national productive forces from the previous one, of taking them away from their previous uses and putting them into the service of new combinations" (p. 250). The Schumpeterian entrepreneur, therefore, does not invent something entirely new but rather deploys *existing* resources into new combinations, which not only suggests a type of materiality that Kirznerian entrepreneurship lacks but also supports the existing resources had a prior objective presence before the Schumpeterian entrepreneur utilized them in a new combination. Note that even though the entrepreneur's idea for a new combination must be subjective, the actual opportunity new combination itself is limited to the objective existence of existing resources.

Schumpeterian entrepreneurship both implies intangible institutions and explicitly incorporates tangible institutions. As in Kirznerian entrepreneurial discovery, Schumpeterian new-combination entrepreneurship implies that institutions play an important role in entrepreneurship. "The carrying out of new combinations we call 'enterprise,'" Schumpeter writes, "the individuals whose function it is to carry them out we call 'entrepreneurs'" (p. 74). Schumpeterian economic development, just as Kirznerian equilibration triggered by entrepreneurial discovery, implicitly requires a set of persistent institutions. On the surface at least, Schumpeterian economic development depends on the same set of intangible institutions as does Kirznerian equilibration and entrepreneurial discovery. The opportunities to carry out new combinations, just as profit opportunities, are shaped by the existing set of institutions. Yet, in articulating "creative destruction"[3] for which he is well known, Schumpeter goes farther and explicitly includes tangible institutions. In *Capitalism, Socialism, and Democracy* (1950), Schumpeter evokes raw materiality, almost animalism, when he describes the effects of entrepreneurship,

> The competition from the new commodity, the new technology, the new source of supply, the new type of organization (the largest-scale unit of control for instance)—competition which commands a decisive cost or quality advantage and which strikes not at the margins of the profits and the outputs of the existing firms but at their foundations and their lives (p. 84).

While the materiality is evident throughout the passage, tangible institutions are particularly indicated he chooses the noun phrase "decisive cost and quality advantage." It is these institutional attributes that are not matters of perception but real and palpable. "The problem that is usually being visualized is how capitalism administers existing structures," Schumpeter (1950) observes, "whereas the relevant problem is how it creates and destroys them" (p. 84). Herein we plainly see that institutions in Schumpeterian entrepreneurship are not ideational but rather material.

Schumpeter's inclusion of institutional costs gestures towards a largely undeveloped link between Schumpeter's classical conception of entrepreneurship and new institutional economics (NIE). The key to NIE economic institutionalism is transaction costs in that they "exist and necessarily influence the structure of institutions and the specific economic choices people make"

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[3] Schumpeter articulates the idea of "creative destruction" not in *The Fundamentals of Economic Development* but rather in "Chapter VII: The Process of Creative Destruction" of *Capitalism, Socialism, and Destruction* (Schumpeter, 1950).

(Furubotn & Richter, 2000, p. xiii), which reflects the same binary construct as institutions and entrepreneurship. As Oliver Williamson (1985) states, "Contrary to earlier conceptions—where the economic institutions of capitalism are explained by reference to class interests, technology, and/or monopoly power—the transaction cost approach maintains that these institutions have the main purpose and effect of economizing on transaction costs" (p. 1). The centrality of transaction costs in NIE points to the use of material, objective, and tangible resources: "With respect to institutions, it is abundantly clear that their use (as well as their formation) requires the input of real resources" (Furubotn & Richter, 2000, p. xiii). In NIE, there is an explicit role for the entrepreneur as an endogenous source of institutional change. As Douglas (1990) North puts it, "Incremental change comes from the perceptions of the entrepreneurs in political and economic organizations n that they could do better by altering the existing institutional framework at some margin. But the perceptions crucially depend on both the information that the entrepreneurs receive and the way they process that information" (p. 8). Thus, NIE can be interpreted as incorporating both tangible institutions and objective, materially bounded entrepreneurial opportunities.

Of course there is more than one "new institutionalism" (Hall & Taylor, 1996; Peters, 1996, 2005; Rockman, 1994). Considerable theoretical empirical work in the economics, political science, and sociology has been done that has developed very strong conceptions of institutions in the varieties of new institutionalism. There is *sociological institutionalism*, which treats modern organizational forms and procedures as "culturally-specific, akin to the myths and ceremonies devised by many societies, and assimilated into organizations, not necessarily to enhance their formal means-ends efficiency [i.e., Weberian rationality], but as a result of the kind of processes associated with the transmission of cultural practices more generally" (Hall & Taylor, 1996, pp. 946-947). For entrepreneurial activity, the most important element of sociological institutionalism is its cognitive emphasis on institutions as "'frames of meaning' guiding human action." This form of institutionalism most closely allies the intangible institutions and subjective entrepreneurial opportunities of Kirznerian entrepreneurship.

Historical institutionalism treats institutions as "formal or informal procedures, routines, norms and conventions embedded in the organizational structure of the polity or political economy" (Hall & Taylor, 1996, p. 938). Parsing the conceptual term "historical institutionalism," Pierson (2000) explains that "historical" is used "because it recognizes that political development must be understood as a process that unfolds over time" and "institutionalism" is used "because it stresses that many of the contemporary political implications of these temporal processes are embedded in institutions—whether formal rules, policy structures, or norms" (pp. 264-265). For entrepreneurial activity, the most important element of historical institutionalism is path dependence. For his historical institutionalist analysis of social provision in the United States, Hacker (2002) defines "path dependence" as follows: "Small initial differences in circumstances may have large eventual effects as self-reinforcing processes encourage continued reliance on established institutions…" (, p. 9). (Also see Arthur, 1994.) Thus, "the continued reliance on established institutions" structure actors' choices, just as both rational-choice and sociological institutions do. Therefore, once again, in terms of entrepreneurial activity, path dependence structures Kirznerian profit opportunities and organizes the possibilities of Schumpeterian new combinations.

The variety closest to NIE is *rational choice institutionalism* that has its roots in economics, specifically in public choice theory (see Buchanan & Tullock, 1962). It treats institutions as generally as both formal and informal rules and procedures (Kasper & Streit, 1998).
Defining institutions as "shared concepts used by humans in repetitive situations organized by rules, norms, strategies" (Ostrom, 1999, p. 37), the most important element of rational choice institutionalism for entrepreneurial activity is its emphasis on strategic actions. "Institutions structure such interactions," Hall and Taylor (1996) write, "by affecting the range and sequence of

alternatives on the choice-agenda to…thereby leading actors toward particular calculations and potentially better outcomes" (p. 945). Rational-choice institutions thus structure actors' choices, though this broad conceptualization of rational-choice lacks the tangible, objective emphasis of NIE as we believe is accurately interpreted above and best supports the tangible conception of institutions necessitated in Schumpeterian entrepreneurship.

Public Sector Entrepreneurship and Institutions

Some scholars argue that there is little difference between for-profit and public sector entrepreneurship or that the differences are trivial (see Bernier & Hafsi, 2007 for a recent example; also see Mintrom, 2000). We argue that institutional differences matter. Our proposition for the relationship between public sector entrepreneurship and institutions is that tangible institutions and objective entrepreneurial opportunities predominate in the public sector. As discussed briefly above, our proposition is grounded in the intuition that in modern liberal democracies there are more tangible institutions in the public sector than there are in the for-profit and nonprofit sectors. Unlike in the for-profit and nonprofit intangible institutional settings, political institutions are material and as such are involved in daily transactions and exchange in the public sector. According to Sheingate (2003), the complexity of political provide "the opportunities for speculation, the resources for creative recombination, and the assets entrepreneurs use to consolidate innovation into institutional change" (p. 191). Thus institutions supply, in Sheingate's words, the stuff that makes up "politics itself." (Also see Ingram & Ullery, 1980.) The opportunities these tangible institutions provide are all objective. As opposed to the intangible "rules of the game," for example, these objective opportunities are largely enabled by concrete rules that "originate in agencies, articulate law and policy limited only by authorizing legislation, and have either a broad or narrow scope but are always concerned with shaping future conditions" (Kerwin, 2003, p. 7). Although these rules are "rich in conflict, contradiction, and ambiguity," as March and Olsen (1989, p. 38) point out, they provide objective boundaries within which bureaucrats—indeed, where most of the public sector entrepreneurship occurs—must interpret and implement (Lipsky, 1980, 2002). Instead of bureaucracies simply carrying out public polices, "In reality a large number of our most important policies are formulated and implemented in the bureaucracy" (Gormley & Balla, 2004, p. xiii).

Therefore, in the public sector, tangible institutions structure objective entrepreneurial opportunities for public sector entrepreneurship. In describing what he calls "the institutional density of politics," Pierson (2000) observes that coordination in politics and elsewhere requires formal institutions: "Both formal institutions (such as constitutional arrangements) and public policies place extensive, legally binding constraints on behavior" (p. 259). Pierson's institutional density might be described as a *horizontal* density as formal institutions and public policies coalesce into an institutional foundation guiding the political sphere as a whole, including any entrepreneurial activity. Similarly, Weaver and Rockman (1993) conceptualize what might termed a *vertical* institutional density in politics as they identify three institutional tiers (p. 446). The first and lowest tier is constitutional checks and balances, which seems to approximate Pierson's institutional foundation of politics, and the second tier consists of electoral rules and norms affecting the formation of political parties and coalitions, which seems more specific and focused than what Pierson had in mind for institutions. The third and highest tier is comprised of a variety of political institutions, "some stemming from constitutional architecture or tradition (federalism, bicameralism, and judicial review, for example) and others from institutional rules or political organization (such as forms of parliamentary voting and party discipline)" (p. 446). Weaver and Rockman's third tier most likely is comprised of the kinds of institutions that would structure the Kirznerian profit opportunities and organize the possibilities for Schumpeterian new combinations.

Institutions are central to any sort of political behavior (March & Olsen, 1984, 1989, 1996), including public sector entrepreneurship. And what Weaver and Rockman above describe as third-tier institutions provide specific opportunities, that is, they "have a reality that reduces the diversity of policy choices that might otherwise be made" (Peters, 1996, pp. 213-214). Institutions supply "decision points" within which entrepreneurial activity can occur (Pressman & Wildavsky, 1984, p. xxiv) and "veto points" in which interest groups to innovate (Immergut, 1992, p. 8). Similarly, American federalism is a third-tier institution that supports "a variety of institutional arrangements that crate distinctive risks and opportunities for governing capabilities" (Weaver & Rockman, 1993, p. 459), including such entrepreneurial activity as "bounded innovation" (Weir, 1992, p. 193). Further, specific institutions create specific entrepreneurial opportunities, Congress as an institution: "Institutional design features and related elements of the U.S. political culture provide the environment in which self-interest is defined for Congress as well as for others in the political system. These design features interact with other environmental conditions in defining what members of Congress will see in their interest" (Aberbach, 1990, p. 138). Political institutions are thus not neutral. As Immergut (1992) puts it, "political institutions help to shape the definition of interests and their expression in politics" (p. 5).

The public administration literature offers several suggestions of what entrepreneurial opportunities might arise within third-tier institutions. Entrepreneurial discovery might be leadership to correct for failures in governance (Behn, 2002). Bellone and Goerl's (2002) "civic-regarding entrepreneurship" is another example in which entrepreneurial discovery might be involved in facilitating "increased citizen education and involvement" and enabling citizens to "have greater opportunities to participate in the design and delivery of their public goods and services" (pp. 388-389). Kirznerian discovery might motivate the creation of a new agency or a new large-scale policy or program. Polsby (1984) identifies several examples of Schumpeterian new combinations, such as "presidents who wish to differentiate themselves from their predecessors and who want to make an individual mark on history—as nearly all do—provide a steady market for policy innovations" (p. 161); "incubation of new policy proposals [in the Senate]…may at some future time find their way into legislation" (p. 162); and even in the House, " from time to time, a member or subcommittee finds a niche from which it can incubate policy innovation" (p. 163). Entrepreneurial discovery must be involved in "entrepreneurial urbanism" (e.g., Ward, 2003); when modern presidents, "unable to depend on support from his own party, needing to cobble together separate coalitions of policy support from both political parties" (Pfiffner, 2001); or in the specific instance when FDR's "administrative improvisation" provoked his to install his New Deal programs in emergency departments because "the old departments [Agriculture, Commerce, Labor, the Treasury], even with new chiefs, simply could not generate the energy and daring the crisis required" (Schlesinger Jr., 1968, p. 219). In summary, as Sharkansky and Zalmanovitch (2000) put it, "improvisation is a commonplace phenomenon, found in virtually all areas of life" (p. 321). Institutions are thus the engine of entrepreneurial opportunities in the public sector.

It should be reiterated that entrepreneurial activity is not the same thing as rational and strategic action. In fact, the two may be diametrically opposed. The work of March and Olsen (1984; 1989; 1996) has conceptualized a "logic of appropriateness" as being "a fundamental logic of political action" within institutions. In the logic of appropriateness "actions are fitted to situations by their appropriateness within a conception of identity" (March & Olsen, 1989, p. 38). And the logic of appropriateness is in direct opposition to the "logic of consequences" in which "actions are chosen by evaluating their probable consequences for the preferences of the actor" (March & Simon, 1993, p. 8).

Generating novelty with the objective opportunities provided by existing, tangible institutions rules is the quintessence of public sector entrepreneurship. March and Olsen (1989) depict "institutional novelty" as "a repertoire of routines is also the basis for an institutional approach to novel situations" (p. 34). The public sector is replete with examples of this kind of institutional novelty, which could just as easily be called public sector entrepreneurship. In answering the question, "What causes innovation?," Polsby (1984) finds that the "incentives to search for innovations" are "incorporated into the constitutional routines of the American political process" (p. 165).

> What our cases [of policy innovation] do seem to show is that parts of the American political system that have come under our scrutiny—institutions by no means contributing to the revolutionary potential of the society-routinely create needs and tensions that frequently are resolved by recourse to the policy innovation process. (p. 161)

Similarly, Doig and Hargrove (1987) note that American federalism gives rise to "fragmentation," which "yields opportunities for policy experimentation and for initiative in building political coalitions that are not as readily available in a coherent and tightly run governmental system" (p. 9). And Linder and Peters (1990) find that institutions do not command or dictate policy but rather provide boundaries as "guidance mechanisms" that associate "the learning side of the process involving knowledge and information use with the adaptation side tied to policy implementation and performance" (p. 61).

In summary, tangible political institutions structure objective entrepreneurial opportunities. Third-tier institutions supply the logic of appropriateness according to which Kirznerian profit opportunities and organize the possibilities for Schumpeterian new combinations might be entrepreneurially acted on. The logic of appropriateness at once constrains and facilitates public sector entrepreneurship. Therefore, institutions are the sine qua non of public sector entrepreneurship.

Nonprofit Entrepreneurship and Institutions

The nonprofit sector, understood as the primary component of the larger notion of civil society,[4] serves a dual purpose in understanding how entrepreneurs discover and create "profit"

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[4] Civil society is made up of what Tocqueville (1832/2000) calls associations, which are nonprofit nonpolitical volunteer organizations that have an extensive presence in countries with democratic institutions.

opportunities in this sector and the for-profit sector. Our proposition for the relationship between nonprofit entrepreneurship and institutions is that intangible institutions and objective opportunites predominate in the nonprofit sector. First, entrepreneurship in the nonprofit sector fills gaps in the provision of goods or services that left to the market or public sectors alone are otherwise unfilled. Certain institutions unique to the nonprofit sector provide the catalyst for entrepreneurs to act and seek these "profit" opportunities in a non-market context. Second, the nonprofit sector acts as a source of institutional change, which as a result generates institutions that assist entrepreneurs in other sectors. Civil society is a powerful force in sustaining democratic institutions and providing important conditions for economic exchange; thus, entrepreneurs are assisted in their profit-seeking through the institutions created by the vast components of the nonprofit sector. Hence, the thesis of Part 5 is that institutions both structure nonprofit entrepreneurship, and the institutions created by this sector help structure entrepreneurial activity in other sectors. What follows is a deeper exposition of this dual role the nonprofit sector plays in the entrepreneurial process.

<u>Institutions that Create Nonprofit Entrepreneurship</u>

A key component of the nonprofit economy is that the conditions which foster for-profit entrepreneurship also help create nonprofit entrepreneurship. Fundamentally, the substantial size of the nonprofit sector in America is the result of several factors: increased efficiency in nonprofit provision of services and the lack of trust in government; market wealth generation and the availability of seed capital for nonprofit entrepreneurs; and the institutional conditions that substantiate the market process, to name a few. Consequently, the Kirznerian and Schumpeterian entrepreneur in the nonprofit sector is guided in "profit" decision-making through the institutions discussed in Part 3. Yet, there exist unique institutions that create incentives for entrepreneurs to establish a nonprofit organization, as opposed to establishing a for-profit firm or seeking provision through the public sector.

The first characteristic of nonprofit entrepreneurship is understanding the types of profit opportunities that create a desire for nonprofit provision of goods or services. Incentives for nonprofit entrepreneurs may come from several areas: ideology, altruism, creative expression, etc. These areas do not provide a perfect substitute for profit in market-based entrepreneurship, but they do provide incentives for individuals to act and, more importantly, they provide incentives for individuals to search for opportunities.

Ideological incentives alert actors to opportunities for betterment especially in sectors where nonprofits do not compete with for-profit businesses. Ideological and altruistic entrepreneurs are alert to actual or perceived needs, opportunities for idea dissemination, or gaps in the supply of something they themselves want to benefit from. For example, this type of entrepreneur sees the need, based on inadequate provision, for an art museum in their particular town. They are alerted to this need by a desire they possess that is unfulfilled and they establish a nonprofit for two reasons: 1) they are altruistically concerned with output (Gassler, 1990), and 2) by forming a nonprofit they are likely to receive donative financing (Hansmann, 1981).[5]

Another type of ideological entrepreneur that might be considered a 'pure altruist' is one that is alerted to a perceived opportunity or need by compassion or religious conviction (Rose-Ackerman, 1996). A class of entrepreneurs exists that establish human service nonprofits (e.g., soup kitchens, homeless shelters) and these entrepreneurs are often concerned with serving others for the sake of their beliefs. Also, certain ideological entrepreneurs are alerted to establish an organization by a lack of provision within the greater culture around them. Among other things, this type of entrepreneur wants to disseminate ideas and, as noted above, they are likely to receive funds only if they do not distribute 'profits' to stakeholders. The nonprofit economy has a different set of signals alerting actors to form nonprofit organizations, and the difficulty in comparing these signals to the

[5] Also see (Bilodeau & Slivinski, 1998; Glaeser & Shleifer, 2001) for a more extensive, purely rational, analysis of the nonprofit entrepreneurial decision.

for-profit economy comes from the ideological nature of these alerting mechanisms. Therefore, two crucial problems arise for nonprofit entrepreneurs to successfully realize their profit opportunities. First, these entrepreneurs must discover how to establish and sustain a nonprofit where donors are potentially an important source of revenue, and second how to maintain a flow of resources in perpetuity. Thus, for the purposes of this conceptual typology, what instructions facilitate entrepreneurs in achieving these ends?

Shleifer (1998) makes the case that nonprofit organizations fulfill a role where neither the state nor the private market has the proper incentive to efficiently produce. In four situations, according to Shleifer, the market and government are inferior to nonprofit provision: 1) opportunities for cost reductions lead to non-contractible deterioration of quality, 2) innovation is unimportant, 3) competition is weak and consumer choice is not effective, and 4) reputational mechanisms are weak. In these four cases, Shleifer is making the point that the market economy has an alternative to government, which is the establishment of nonprofit firms. He states, "entrepreneurial not-for-profit private firms can be more efficient than either government or the for-profit private suppliers…where soft incentives are desirable, and competitive and reputational mechanisms do not soften the incentives of private suppliers" (Shleifer, 1998, p. 140). Whether justifiable or not, schools, hospitals, day-care centers and other organizations raise concerns about the appropriateness of private provision.

Two important institutional catalysts (both of which fit broadly into rational choice and sociological institutionalism), emphasized by Shleifer's justification for nonprofit provision over government provision, provide incentives for these entrepreneurs. The first is the non-distribution constraint, and the second is reputational considerations. Nonprofit organizations are organized where they cannot distribute any net earnings (pure profits) to individuals who exercise control over the organization (Hansmann, 1980). Nonprofits may earn profits, but the entrepreneur does not realize these monetary profits in the same way as a for-profit entrepreneur. If a nonprofit organization earns monetary profit, it cannot distribute those profits to the owners or employees, so those profits are returned to the organization for operation or program purposes. This non-distribution constraint does not allow nonprofits to distribute surpluses to stakeholders (whereas in for-profit organizations stakeholders expect to reap personally the residual of revenues minus costs). With the non-distribution constraint in place, nonprofit entrepreneurs signal donors to give in order that their funds be used for the provision of a specific good or service and these funds will not be used for non-program purposes.

The importance of reputation builds upon the importance of the non-distribution constraint. Since donations are the lifeblood of the nonprofit entrepreneur, he can comply with the wishes of the donor or he can renege and use the funds for other purposes. Rose-Ackerman (1996) emphasizes that any firm has its reputation at stake in this type of situation, but a nonprofit organization is less likely to renege because of donor limitations on how funds are spent and the consequences of losing donors. If a nonprofit organization abuses donor intent by misusing funds and such misuse of funds is exposed, the reputation and therefore the existence of a nonprofit will be in serious jeopardy. Maintaining a positive reputation as to the use of funds in terms of fulfilling organizational mission provides discipline to a nonprofit entrepreneur that mimics loss in the for-profit sector. Loss of donations will follow a marred reputation.

Nonprofit Entrepreneurship as a Source of Institutional Change

Civil society creates an environment where two crucial components for a healthy society exist: 1) conditions necessary to sustain democracy, and 2) conditions leading to economic development (in part through entrepreneurship). Associations often form in order to provide individuals with a collective voice to communicate with large commercial or government institutions. In addition, these organizations or associations that are the foundation of civil society are said to be social capital institutions (Beem, 1999). These institutions consist, not only of family and church, but also of community groups, neighborhood associations, and the like. This concept of social capital—or the mutual benefits gained from social networks emitting trust, reciprocity, or norms—is a byproduct of a strong civil society. As Putnam points out, the strengthening of social networks that leads to increased social capital has positive economic consequences (Putnam, 1993). Social capital is, not only an important condition for sustaining democracy, but also it is an ingredient that leads to economic growth through entrepreneurial activity.

Civil society organizations, in part, breed the necessary institutions for economic development broadly, and entrepreneurial activity specifically. Social capital, trust, reciprocity, and the like all play a vital role in shaping how people interact in a market environment, and they lay the groundwork for informed exchange and the allocation of resources. Civil society also generates what some have termed "civic spirit." Gellner (1991) refers to civic spirit as the presence of moral conscientiousness that binds a man to contractual obligations and the like, and this spirit is a necessary (yet not sufficient) condition for economic exchange.

Trust is a positive byproduct that arises out of civil society and the development of social capital. In his book *Trust* (1996), Fukuyama carefully develops the idea of trust and demonstrates how it has a significant, measurable economic value. Trust is another ingredient in the overall institutional structure of a well functioning market economy. Trust helps minimize uncertainty, and thus facilitates economic transactions. In this sense, civil society as a generator of social networks and trust relationships is responsible for enhancing the environment where economic development and entrepreneurship can thrive.

The market economy by itself does not produce the morally beneficial attributes that arise from social networks and the civic spirit highlighted above. Consequently, a healthy civil society is necessary to supplement a healthy market economy. Set alone, utilitarian values weaken the market in the absence of social networks and trust relationships (Eberly, 1998). This relationship then between civil society and the market forms what Bruyn calls a civil economy. Specifically, he argues that civil society arose, in part, out of the market economy based on the need to infuse the market with necessary checks or self-regulations (Bruyn, 2000). Thus, the composition of civil society consists of nonprofit organizations that participate with the market in order to fulfill the invisible hand role that Adam Smith spoke of over 200 years ago. The institutions generated by these nonprofit organizations are an essential part of this economic participation, which facilitates entrepreneurial activity specifically within a for-profit market environment.

In summary, instructions structure entrepreneurial activity both within the nonprofit sector and as a result of a healthy dynamic nonprofit sector. For the Kirznerian and Schumpeterian entrepreneur who discover and create in a nonprofit context, the incentives guided by the non-distribution constraint and reputation are an important part of the entrepreneurial decision. Additionally, the institutions bred by the nonprofit sector help to structure entrepreneurship within a for-profit context. This dual role of institutions demonstrates the paramount role of a typology designed to capture what currently exists when nonprofit entrepreneurs act.

Conclusion

A fascinating dimension of the Popper-Kuhn debate concerns scientific progress. In each system, is a standard of progress by which it can be determined that progress has occurred articulated or implied? And are the mechanics of mechanics of progress, or the mechanism through which scientific progress occurs, articulated or implied? Popper's rationalist view of scientific progress, however, begins to break down as soon as a standard for progress is sought. Popper knows that some sort of measure to determine whether progress has occurred is required. For example, he writes in *Objective Knowledge* (1989): "I intend to show that while we *cannot* ever have sufficiently good arguments in the empirical sciences for claiming that we have actually reached the truth, we *can* have strong and reasonably good arguments for claiming that we may have made progress towards the truth…" (Popper, 1989). In the *Logic of Scientific Discovery* (1992) he boldly asserts the existence of such a standard when he writes:

> The game of science is, in principle, without end. He who decides one day that scientific statements do not call for any further test, and that they can be regarded as finally verified, retires from the game. (2) Once a hypothesis has been proposed and tested, and has proved its mettle, it may not be allowed to drop out without 'good reason'. (Popper, 1992)

Popper might even believe that he provides such a standard. For example, he offers a "*criterion of progress*: even before a theory has ever undergone an empirical test we may be able to say whether, provided it passes certain specified tests, it would be an improvement on other theories with which we are acquainted" (Popper, 1985a). Yet, other than occasionally mentioning a vague notion of "metascientific knowledge," Popper never substantiates this criterion of progress or any other possible standard of progress. "In science (and in only in science)," Popper writes, "can we say that we have made genuine progress: that we know more than we did before." (Popper, 1970). But without a standard there is no way to confirm that genuine progress has occurred.

By contrast, the main weakness in Kuhn's system is that there is no continuity. Without continuity between paradigms scientific progress cannot occur because there is nothing for the new paradigm to build upon. "Continuity underlies change…If this continuity is ignored, Kuhn's new response in defence of 'incommensurability' would fail to rebut the old criticism that incommensurability leads to incomparability and incomparability to irrationality" (Gupta, 1993) Kuhn's system "…may explain progress and justify 'normal' choice *within* a paradigm. It does not explain progress that survives paradigm change" (Gupta, 1993). Kuhn admits as much when he writes: "If I am right, then 'truth' may, like 'proof', be a term with only intra-theoretic applications [i.e., within paradigms]" (Kuhn, 1970, p. 266).

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