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MARX ON ENTREPRENEURSHIP: A NOTE

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Abstract: *This paper argues that in mainstream economics the concept of entrepreneurship is imposed by the theoretical framework adopted in order to justify the source of profits. In contrast, in Marx's analysis there is a consistent theory of profit which inevitably leads to a specific theory of entrepreneurship.* (JEL: *B10, B14, B21*)

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1. *Introduction*

Entrepreneurship has always been a debated topic in economic literature. Different opinions about the role, the meaning, and the raison d'être of entrepreneurship have risen and been developed from different schools of economic thought[1]. Nowadays, it is argued that the evolution of the capitalist production process makes it imperative to treat entrepreneurship as a separate factor of production whose importance is associated with the emergence of modern capitalism. Even more, "given the vital role of entrepreneurs in a private economy, the analysis of entrepreneurship must surely occupy a

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[1] Among the first who used the term "entrepreneur" in its modern sense is Richard Cantillon in the 1730's whereas, few years later J.B. Say noted that "the term *entrepreneur* is difficult to render in English; […] It signifies … the person who takes upon himself the immediate responsibility, risk, and conduct of a concern of industry, whether upon his own or a borrowed capital" (Say [1803] 1964, p. 328). An introduction to the historical development of the concept of entrepreneurship can be found in Ebner (2005) and in many others.

central role in the investigations of economists" (Blaug, 1987, p. 219).

This paper claims that the inquiry of entrepreneurship should focus on the origin of profit as a condition *sine qua non*. The argument is that if the source of profit is unknown, then it is pointless to discuss who deserves it. In fact, what we witness in the relevant literature is that the controversy surrounding profit theory has shifted onto entrepreneurial theories and any argument on entrepreneurship inevitably leads us back to the concept of profit and its source. In what follows, we discuss Marx's views on profit and entrepreneurship and, at the same time, present the arguments developed in main stream economic literature.

2. *Profit Origin and Entrepreneurship*

There is clear agreement among economists regarding the definition of profit, that is, revenue from sales minus costs; however, when it comes to the determinants of profit there is anything but agreement. A number of explanations for this residual income have been developed, such as: implicit rent, interest, wages, reward for innovation, payment for risk-bearing, a residual in a world of uncertainty, earnings deriving from monopoly and surplus value produced by exploited labour. For both, classical economists and Marx, profit is the surplus produced in the production process. Neoclassical theory, on the other hand, has produced a variety of reasons as to why profit exists and, as a consequence, there are several justifications as to why entrepreneurs deserve profit.

The persistent inquiry into profits in economic theory stems from the fact that in capitalism the appropriation of profit takes place through an economic mechanism whose understanding becomes imperative to any economic theory[2]. In fact, all theories of entrepreneurship[3] emerged from the need to provide an explanation for the source of profit which should originate in economic mechanisms. Hence, the discussion on entrepreneurship inevitably leads to discussions on the origins of profit and to profit theories which, then, hold centre stage in economic literature. Starting from Smith [1776], it has

[2] In contrast, in other systems, like feudalism or even command economies, the appropriation of surplus takes place through the implementation of various political mechanisms.

[3] Mainstream analysis, from early stages, in its effort to theorize the origins of profit income, attached to entrepreneurship special characteristics that place it on par with the other factors of production. The remuneration of the new factor is profit, whereas for labour it is wage, for land it is rent and for capital (mainly financial) it is interest.

been recognized that profit is the driving force in a capitalist economy and the pursuit of profit by business regulates the capitalist economic system. Profit is the life blood of capitalism and the dominant organizing principle of capitalist society as a whole (Heilbroner, 1985). Hence, for any thorough understanding of profit it becomes imperative to identify not only who in the production process contributes to its creation and therefore deserves it, but also to comprehend the inner nature of capitalism itself.

Classical economists[4] theorized profits as part of the residual/surplus produced and, in so doing, they provided a coherent theory grounded on the production rather than on the circulation (exchange) sphere of the economy. Based on this analytical framework, Marx places at the core of his profit theory the specific form of the production process under capitalism; he argues that a clear and specific institutional/social foundation is needed for profit to emerge. Furthermore, Marx notes that a scientific analysis of capitalism is not possible "before we have a conception of the inner nature of capital" (Marx [1867] 1967, p. 316) which, as Rosdolsky (1977) mentions, is the production of surplus value and the self-expansion of capital itself; in other words, the capitalist accumulation.

In a capitalist economy, according to Marx, by selling his/her labour power and being employed in the production process a labourer adds more value to production than is required for his/her survival and receives as a wage. This surplus value is clearly a matter of exploitation and arises only under the specific social relations of property identified within capitalism. The various property incomes (profits, interest, rent, etc.) arise from distributing the surplus value among the owners of various kinds of property. Profit is a residually determined income that results from the subtraction of rent paid to landlords, interest paid to financiers, taxes paid to the government, etc. from the total surplus value produced. This residual income accrues to the entrepreneur as the owner of the means of production and not as a wage to the organiser of the production process. The entrepreneur is theorized as the capitalist, who sets up the production process and risks his capital in the pursuit of maximizing profits.[5]

For both classical economists and Marx, entrepreneurship was not elevated

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[4] Among classical economists there are important differences with respect to profit theories. For instance, J.S. Mill [1848] argues that gross profits on capital consist of management wages, a risk premium and interest. He also distinguishes between the capitalist earning interest for abstinence and the employer (entrepreneur) earning a compensation for risk and wages (Blaug, 1983)

[5] For a detailed discussion on entrepreneurship by classical economists, see Schumpeter (1954).

to a status of a factor of production alongside labour, land and capital deserving a specific and unique remuneration. In fact, Smith [1776] did not distinguish in any way between the capitalist as a provider of the means of production of an enterprise and the entrepreneur as the ultimate decision maker. Schumpeter (1954, p. 556) notes that "Ricardo, the Ricardians and also Senior […] almost accomplished what I have described as an impossible feat, namely, the exclusion of the figure of the entrepreneur completely". Similarly, Blaug (1987) argues that in Marx's analysis there is an absence of the notion of the entrepreneur and he treats the running of a business as simply an adjunct to the provision of capital funds[6].

In mainstream economic literature and due to the failure of the general equilibrium approach[7] to provide a satisfactory explanation of the source of profit, we find various profit-earning functions or entities in an effort to provide a more pragmatic view as to who deserves profits. Marshall [1890], for instance, conceived of the entrepreneurial function as a separate factor of production, whose contribution to production renders profits[8]. His discussion on entrepreneurship, however, paid more attention to the routine activities of managers and supervisors than to the innovative activities of the entrepreneur (Pesciarelli, 1989) and thus, Marshall leads us to define entrepreneurship as merely a special kind of labour, part of firm's human capital, deserving

[6] Blaug (1987) mentions that classical economists failed to highlight the distinctive character of the entrepreneurial function because at that time business was small and the owner of the means of production was also the manager; however, he notes that this neglect should not have taken place since they were aware of Cantillon's analysis of the entrepreneur.

[7] Within the framework of general equilibrium, entrepreneurship has an active role only in states of competitive disequilibrium. "When perfect competition has done its work, when we have reached short-run and long-run equilibrium, labour receives 'wages' in accordance with the marginal product of labour, capital receives 'interest' in accordance with the marginal product of capital goods, but 'profits' have been eroded, thus eliminating the entrepreneur" (Blaug, 1987, p. 221). Walras [1874] clearly states that, in equilibrium, entrepreneurs make neither profit nor loss and they are eventually eliminated. However, there are important developments within the general equilibrium approach and the Walrasian version has been enriched. Though, with regard to profit theory, the Walrasian approach (for a comprehensive treatment see Walsh and Gram, 1980) remains the pillar of general equilibrium economics and "after a century or more of endless refinements of the central core of general equilibrium theory, the theory has made no substantial progress on Walras's own theorizing" (Blaug, 1987, p. 219).

[8] Additionally, Marshall ([1890] 1959, pp. 138-139) mentions a fourth productive factor, the 'organization', a concept wider than the 'entrepreneurial function'. The reason for this acknowledgment is that the organization's importance increases as knowledge becomes 'our most powerful engine of production'. Hence, he considers the ownership of knowledge as a source of profit, as well.

wages and not profits. The advancement of the profit-wage approach[9] to entrepreneurship added nothing substantial to the discussion of the source of profit and treated profits as a peculiar kind of wage consisting of the surplus over and above interest, rent and wages paid on common labour (Obrinsky, 1983). No explanation is given as to how such surplus is produced and why it should be paid only to entrepreneurial labour[10].

Marx argues against the view that profits can be seen as wage-income. He notes that "With the development of co-operation on the part of the labourers and of stock enterprises on the part of the bourgeoisie, even the last pretext for the confusion of profit of enterprise and wages of management was removed, and profit appeared also in practice as it undeniably appeared in theory, as mere surplus-value, a value for which no equivalent was paid, as realised unpaid labour. It was then seen that the functioning capitalist really exploits labour and that the fruit of his exploitation, when working with borrowed capital, was divided into interest and profit of enterprise, a surplus of profit over interest" (Marx [1894] 1981, p. 389).

For Marx, the social attribute of capital under capitalist production that is the property of commanding the labour power of another, is the generator of surplus and by extension of profits. Otherwise, "[…] the process of production, separated from capital, is simply a labour process […] Therefore, the industrial capitalist, as distinct from the owner of capital, does not appear as operating capital, but rather as a functionary irrespective of capital, or, as a simple agent of the labour-process in general, as a labourer, and indeed as a wage-labourer". In so doing, "the labour of exploiting and the exploited labour both appear identical as labour" (Marx [1894] 1981, pp. 382-383). But, if this is the case and capital assumes only its economic-function and not its social property, then the capitalist disappears from the production process. The reason Marx gives for this elision is that "the mere owner of capital, the money-capitalist, has to face the functioning capitalist, while money-capital itself assumes a social character with the advance of credit, being concentrated in banks and loaned out by them instead of its original owners, and since, […] the mere manager who has no title whatever to the capital, whether through borrowing it or otherwise, performs all the real functions pertaining to the functioning capitalist as such, only the functionary remains

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9 The profit-wage approach was initially set out in the writings of Say, Malthus and Senior and fully developed by Roscher and Pierson.

10 Pierson (1902) argues that entrepreneurs receive wages due to their reputation without performing any work; this, however, leads us to treat the stockholders as wage receivers and by extension ownership as the source of this peculiar type of income.

and the capitalist disappears as superfluous from the production process" (Marx [1894] 1981, p. 388).

In Marx (1869), the profit motive gives rise to recurrent economic patterns which are amenable to abstract theorization and competition among capitals is the mechanism by which the laws of capitalist accumulation operate and become visible: "Competition makes the immanent laws of capitalist production to be felt by each individual capitalist, as external coercive laws. It compels him to keep constantly extending his capital, in order to preserve it, but extend it he cannot, except by means of progressive accumulation" (Marx [1867] 1967, p. 592). Competition among individual capitalists forces them to innovate and therefore to assume risks. The profit motive is what keeps wages as low as possible, forces capital to seek out cheaper labour, constantly drives toward the mechanization of production, introduces technological changes to lower cost, etc.; in short, the profit motive regulates the competition of capitals (Shaikh, 2004). By introducing better techniques and more advanced equipment in order to reduce per unit cost, an individual capital may acquire temporarily higher profits, which, however, in the long-run vanish. In a dynamic economy, the working of free competition guarantees that each capital receives tendencially the economy's long-run average profit rate. Hence, innovation is not a possible source of profits, except temporarily.

Schumpeter [1911], on the other hand, argues that profits exist due to imperfections in the market arising from the normal functioning of a dynamic economy; hence, in a static economy entrepreneurs, like profits, simply do not exist. Ultimately, Schumpeter traced all disruptive economic change to the process of innovation and he then identified the innovator with the entrepreneur[11] who for this peculiar function acquires profits (Blaug, 1987). In Schumpeterian analysis, risk is not part of the entrepreneurial function because profit is not connected with invention itself but rather with its introduction into the production process. But if this is the case, the patent system could give this 'surplus' generated over the cost of production not to the entrepreneur, who simply introduces or applies an invention, but to the inventor. Consequently, the 'surplus' generated by the process of innovation can no longer be considered as profit (Obrinsky, 1983).

[11] In Schumpeter, entrepreneurial activities drive the economy out of equilibrium and as a result earn transient profits. In the new-Austrian school, on the other hand, entrepreneurial activities perform exactly the opposite task, which is to restore equilibrium (Ioannidis, 1993). Schumpeterian entrepreneurship as a concept is influenced both by Austrian marginalism and the German historical school (Ebner, 2005).

Marx did not view risk taking or the presence of uncertainty as possible sources of profits, except temporarily, since competition tends to eliminate this kind of excess profit and, in general, profit and loss due to these factors are secondary and ephemeral features of the dynamics of capitalism. In the "risk theory of profit" advanced by Hawley (1907) and Knight[12] (1921), however, risk becomes the central source of profit and entrepreneurs, by assuming these risks, deserve payment in the form of profits. In this scenario, the whole organization of the production process under capitalism turns into a huge gambling arena and the riskier the entrepreneur the higher the gains. In an effort to escape from this trap, Hawley ended up arguing that a distinct closed class of individuals (i.e. a guild) receives profits independent of their contribution to production. Knight realized that this non-contractual gain cannot be the price paid for a specific service, for that would imply a direct connection between the level of profit and the burden of bearing risk. Thus he argued that the true uncertainty about the future allows entrepreneurs to earn positive profits despite long-run equilibrium and product exhaustion in accordance with the marginal productivity of inputs. However, there is no analysis or assessment of the causes of risk in Hawley's and Knight's work and it is not clear who will take the responsibility for assuming risk in a modern company, the board of directors, the stockholders, or insurance companies? In fact, within this approach, profits cannot be positive unless there is non insurable uncertainty, which in probabilistic terms should have zero expected value.

For Marx, improvements in productivity caused by better organization or innovation or intuition, etc. affect the total surplus value produced and, thus, an innovative entrepreneur may acquire a higher share of the total surplus value produced in the form of profits. However, the level of productivity is only a necessary, and not a sufficient condition for the level of surplus value. Surplus value and profits arise because of the specific social relations of property identified within capitalism. Surplus value is produced by labourers and it is appropriated by capitalists because of specific capitalist property relations. According to Marx, the guiding motive and ultimate goal of capitalist production is to extract the greatest possible amount of surplus value; and how much surplus value is produced in the production process is determined by the conditions of production set by competition.

The capitalist's motive is to maximize not the sum of profits or the total

[12] Knight began by making the distinction between 'uncertainty' and 'risk'. He argued that uncertainties can be reduced to objective measurements and, therefore, they can become part of the costs of production; consequently, only risk leads to profits.

amount of surplus value but rather the rate of profit on the total capital invested. Methodologically, the definition of normal profits as a reward for an entrepreneur's services to the production process requires the determination of a standard norm, and prior to that, the source of profit. Thus, if profits reward entrepreneurial innovation, normal profit must have reference to either a normal rate of innovation or a normal reward for innovation, which, by definition, is contradictory. In addition, if normal profit is a return for entrepreneurial activity, then the rate of profit must mean the ratio of profits to the 'stock of entrepreneurship'. In the case that profit is a reward for uncertainty, the rate of profit should be taken as the ratio of profits to the amount of uncertainty. In all these cases, the definition of normal profit is problematic and the need for its theoretical understanding is even more demanding, since the actual business decisions are conditioned by the notion of normal profits.

Free competition is the mechanism that ensures normal profitability for all capitals invested; normal profit within a Marxian framework accrues to the capitalist/entrepreneur because, by being the owner of capital invested, he/she has the ability to command labour and, by extension, to appropriate the surplus value produced. Within this surplus framework, the analysis of entrepreneurship was never isolated from the ownership of the means of production, which, in fact, is promulgated as the solid source of profits.

Rosenberg (1994) and Blaug (1987) note that Marx does not give an explanation for the actual source of the technical dynamism of capitalism stemming from the actions of an entrepreneur (Schumpeterian analysis), and he simply conflates the functions of the capitalist and the entrepreneur. Commenting on Marx's views on innovation, Schumpeter noted that Marx linked investment to technical change in a manner not to be found in other writers of the period and, as with other classical economists, capital accumulation was the main driver of innovation. In *Capitalism, Socialism and Democracy* (1947, pp. 16 and 32), however, Schumpeter was critical of Marx for his failure to acknowledge the contribution of individuals of superior energy and intelligence (leaders) and castigated him for having no adequate theory of enterprise (Prendergast, 2005).

Marx argued precisely against such a view and he extensively acknowledged that the technological dynamism of capitalism is the outcome of competition and not the inspiration of some 'enlightened' individuals. By acknowledging the apologetic efforts of "representing profit not as a surplus-value derived from unpaid labour, but as the capitalist's wages for work performed by him" (Marx [1894] 1981, p. 389), Marx clearly states that profits arise from the specific socio-economic relations of capitalism that allow for the appropriation of surplus produced by unpaid labour. The analytical framework of the surplus approach to profitability leaves no room for the entrepreneurship as an additional factor of production. The profit motive and the nature of capital, as a self-expanding entity, set in place objective 'laws of motion' and as such no 'special subjective entrepreneurial skills' can exist to give rise to different behaviour from what competition dictates. That is to say, the social function of capital defines the capitalist production process and its ability to command labour facilitates the appropriation of any surplus realized as profit.

3. *Concluding Remarks*

Mainstream economic theory, despite its efforts, did not manage to advance a satisfactory theory of profit. The general equilibrium variant together with the marginal productivity variant of the neoclassical theory provides only two alternatives to the profit puzzle: either profit is the result of disequilibrium or it is a return to a factor of production. In the latter case, profit is indistinguishable from wages unless the entrepreneurial function is rewarded with profits regardless of its employment.

In an effort to tackle these problems, mainstream economic theory has suggested that economic profit is either a reward to the entrepreneur for bearing risk or it is a product of uncertainty or it is an outcome of innovational behaviour. Insofar as risk is taken in a probabilistic sense, the gain of one is a loss to another; therefore profit does not necessarily go to risk bearers but is decided by good fortune. On the other hand, the idea that profit as a product of uncertainty is also misleading because it suggests that the service of bearing uncertainty is rewarded by profits and, as in the case of risk, it has to be viewed as the source of both profit and loss. The view that profit is a product of innovational behaviour contradicts the adoption of an equilibrium analysis insofar as innovation is continual. Hence, in mainstream analysis, economic profits must be regarded as 'accidental', something which only temporarily can justify the existence of entrepreneurial activity.

As Blaug (1987, p. 103) notes whatever is meant by entrepreneurship, whether it is the arbitrage function (Cantillon), or the co-ordination function (Say), or the innovation function (Schumpeter) or the uncertainty-bearing function (Knight), there is no room for entrepreneurship in the neoclassical theory of the firm. There is no arbitrage because all adjustments are instantaneous; there is no co-ordination because all constrains on the use of inputs are fully known; there is no innovation because novelty of any kind would imply some uncertainty about the future and there is perfect knowledge of the future. In short, we can have either entrepreneurship or the neoclassical theory of the firm but we cannot have both (Barreto, 1989, p. 132).

On the other hand, the classical approach to profitability, has presented a consistent theory of profit according to which profits are part of the residual/surplus value produced. The classical/Marxian analysis by focusing on the production sphere of the economy argues that the source of profit can be found in the specific institutional foundation of capitalism. Ownership of the means of production gives the right to the owner-entrepreneur to appropriate part of the surplus produced by labourers in the process of production. Profit is a residual element that accrues to the capitalist/entrepreneur because he/she owns the means of production and not because he/she is the organizer of the production process.

If profit is the driving force of a capitalist economy and the pursuit of profits by business motivates the capitalist economic system, then it becomes imperative to find a sound theory explaining the source of profits. The only coherent account of profit is the one that refers to the increase in the size of property. No other motive can explain the entrepreneurial activity of the owner of the means of production. “At best, entrepreneurship is just another word for capitalist behaviour” (Naples and Aslanbeigui, 1996) and it can be used to declare not a separate function, as neoclassical economists do, but to denote the different level of success that the owners of capital reach in their attempt to increase the value of their property. Competition among capitalists forces entrepreneurs to be successful. Those that lack the ability to manage well and foresee the future eventually will be driven out from the market by others who are better entrepreneurs.

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