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Innovation: a financial asset of the capitalist or an “intellectual property” of the entrepreneur?

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Abstract

The purpose of this study is to identify the specific subjects that deal with innovation, in order to understand if the innovation “belongs” more to the capitalist or to the entrepreneur, and if there is any difference between the capitalist and the entrepreneur in terms of commitment, risk, and expectations. In this study a literature review methodology is used for classifying the capitalist and the entrepreneur form different profiles and in relation with the innovation process. Data are obtained mainly from books and articles, relying on an interdisciplinary perspective. Research findings show that the figure of the capitalist is distinguished from that of the entrepreneur in front of business activities. Thus, the capitalist is financially committed by offering the capital, expecting as a return the financial interest rate, and assuming a financial risk. Instead, the entrepreneur is committed with innovation and change, expecting the profit as remuneration for the assumed organizational risk.

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1. Introduction

Entrepreneurship and innovation are two concepts that deserve to be treated synchronically. Seeing them separately is like reading a book ignoring its author. Innovation, as a driving force of enterprise and the economy, is the manifestation of insights, hypotheses and tests of a defined observer. Therefore, innovation more than a fact is

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an act (process or driving force) to be attributed to one or more subjects that stimulate it. The cradle of the highest relief for innovation is the enterprise, and those who take care of this process are the entrepreneurs, governing bodies or, if widespread the entrepreneurial culture, some division of enterprise under the direction of an innovation project manager.

It follows that entrepreneurship and innovation are two concepts indistinguishable; one is the cause and the other the effect, even if in an evolutionary perspective the relation cause-effect would not be linear but cyclical (i.e. an initial innovation caused by the entrepreneur can cause further entrepreneurial behaviors, stimulating further innovations). Viewed in a larger system, entrepreneurship and innovation are at the same time contributing factors and logical components of the capitalistic evolution. Then, innovation, entrepreneurship, and capitalism become a unique trilogy, essential for understanding today and yesterday business dynamics. Consequently, a first analysis concerns a historical overview on entrepreneurship and innovation in a capitalistic evolutionary perspective. Next, emerge physiologically some questions related to the responsible subjects about innovation. Thus, if entrepreneurship is a phenomenon generated by entrepreneurs and capitalism a phenomenon conceived by the capitalists, then, innovation is the procreation of entrepreneurs or capitalists? Is there any coincidence or divergence between the two figures/roles? The answers to these questions require again historical references and reflections in order to highlight the figure of the capitalist from that of entrepreneur, and then to continue with the various entrepreneurial subjects that deal with innovation, emphasizing the close relationship between entrepreneurship and innovation.

The decision to introduce innovation, first with a capitalist vision of the general economy, descending after that toward the spectrum of entrepreneurship and business enterprise, was not random but resulted from the stimulus to reconcile the levels of economic science: the general economy with the business economy. Economists often do not explain many phenomena of the economic system, because by synthesizing excessively the economic science they lose sight of the focal component that sets in motion the economic system itself (i.e. the enterprise). On the other hand, the corporatists make the same mistake, because they forget to be subsystems of a larger system: the economy. Often we analyze issues in the same discipline (although in different levels) forgetting that the levels are intertwined. Moreover, to explain the complexity of today's business and economic phenomena and their effects on economy, society, and environment, is not enough the interaction between macroeconomics, microeconomics and business economics, but it is vital to be familiar with knowledge from "unrelated fields" (e.g. sociology, psychology, physics, mathematics, cybernetics, sustainability, etc.).

2. Historical excursus of innovation

"The future has an ancient heart"

Carlo Levi

The topics of entrepreneurship and innovation have been and still are central, not only in business economics, but also in economic science in general. Indeed, it is the era of classical economics which date the first formulations of entrepreneurship and innovation. The word entrepreneur comes from the French word "*entreprendre*" which means undertaking (a business initiative), commitment (with business challenges) or taking (the risk). Among the first authors to popularize the term in the economic field (political economy and economics of enterprise) were the Franco-Irish Richard Cantillon and the Frenchman Jean-Baptiste Say. For Cantillon (2010), the entrepreneur with his business activity is the only force that sets in motion the entire economic system (figure 1). Cantillon, as a banker and businessman, he studied not so much the political economy as the business economy, to the point that some authors attribute to him the label of the "father of the business economy".

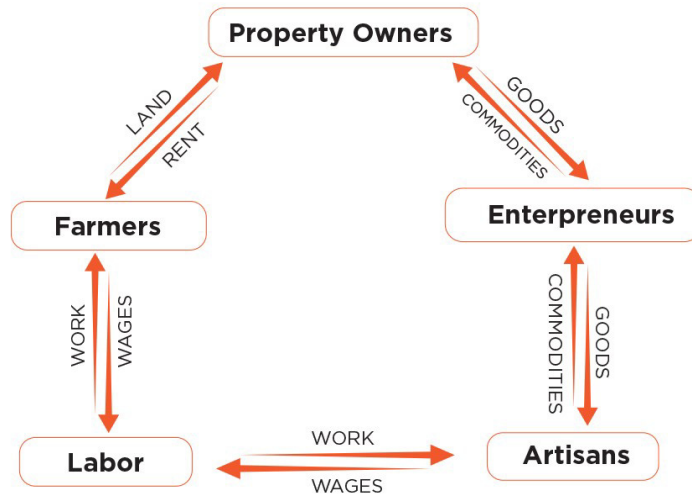


Fig. 1. Economic circular flows of Cantillon
Source: Cantillon, (2010)

For Cantillon, the entrepreneur is the person who exchanges the goods for a profit by exercising business judgments in the face of uncertainty. The uncertainty stems from the fact that the entrepreneur buys inputs or raw materials at a certain price to sell outputs or finished products in the future at an uncertain price. The difference between uncertainty (revenues) and certainty (costs) determines the profit or loss for the entrepreneur (Hérbert and Link, 2009; Hayek, 1985, p. 217-247).

Influenced by Cantillon, and following the scheme of economic circular flows in his *Tableau Economique*, François Quesnay (1758) – the founding father of physiocracy – defines the farmer as an entrepreneur (Spiegel, 1983). It is precisely from the farmer entrepreneur (i.e. the farmer of land) from which starts the flow of production and consumption, following then with flows that include property owners and artisans (Robinson, 1974, p. 16-17).

In turn, Adam Smith defines the entrepreneur as a person of unusual foresight that could recognize the potential demand for goods and services. The entrepreneurial spirit, according to Smith (1976), is based in the selfish impulses of the producers. This is well expressed in one of the most famous quotes of Smith: “*It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages*”.

Distinguished member of entrepreneurship, Jean-Baptiste Say exclaims the entrepreneur as the man who promotes economic development. The entrepreneur of Say is the person who transfers economic resources from an area of low productivity to another one of high productivity and economic performance (Say, 2001). According to Ricossa (1991), which resumes Say, the production is utility creation, and in this sense all factors of production, labor as well as land and capital, create utility and are entitled to a remuneration.

Say’s question of “creation” becomes an inspirational principle for Joseph Schumpeter, who doesn’t see any difference between creation and destruction, provided that the destruction is creative (Schumpeter, 1943). Schumpeter attributes the act of *creative destruction* to the entrepreneur. As a consequence, entrepreneurship and innovation (creative destruction) emerge simultaneously. Innovating, entrepreneurs become more competitive and the *modus operandi* of competitiveness determines the evolution of capitalism, evolution that is expressed in the destruction of the “old” and simultaneously in the creation of the “new”. The binomial destruction-creation contains within itself a Smithian vision, where the mechanism of the invisible hand ensures survival to those companies that are able to compete better with innovation (creative destruction), that is, with new products, new technologies, new supply markets, new organizational structures. At that point, the creative destruction becomes the essence of

capitalistic evolution. In this regard, Schumpeter says: “*The essential point to grasp is that in dealing with capitalism we are dealing with an evolutionary process[...] Capitalism, then, is by nature a form or method of economic change and not only never is but never can be stationary. And this evolutionary character of the capitalist process is not merely due to the fact that economic life goes on in a social and natural environment which changes and by its change alters the data of economic action; this fact is important and these changes (wars, revolutions and so on) often condition industrial change, but they are not its prime movers. Nor is this evolutionary character due to a quasi-automatic increase in population and capital or to the vagaries of monetary systems of which exactly the same thing holds true. The fundamental impulse that sets and keeps the capitalist engine in motion comes from the new consumers’ goods, the new methods of production or transportation, the new markets, the new forms of industrial organization that capitalist enterprise creates[...] The opening up of new markets, foreign or domestic, and the organizational development[...] illustrate the same process of industrial mutation[...] that incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has got to live in*” (Schumpeter, 1943, p. 82-83).

In reference to the business judgment in front of uncertainty, in a similar line to that of Cantillon, proceeds also Frank Knight. For him, “*business risk relates to the exercise of judgment in the making of decisions by the business man [entrepreneur]*” (Knight, 1964, p. 251). Frank Knight associates to the entrepreneur, based on the possessed knowledge, a calculable risk (aleatory risk) and another not calculable (risk of ignorance or uncertainty) (Proietti, 2011). Knight’s considerations on the risk, uncertainty and profit become crucial to understand then the difference between the capitalist and the entrepreneur.

3. The Capitalist Vs the Entrepreneur

The evolution of the business enterprise has determined in much also the evolution of capitalism, involving different subjects within its system (capitalists, entrepreneurs, managers, employees, etc.). Given that capitalism has been and is the system powered by the free market, we should understand what is meant by the term “capitalism”.

In 1918, when the German economist Richard Passow made a survey on the literature of capitalism, allegedly found approximately 111 definitions related to it (Kocka, 2010). For instance, Marx saw capitalism in terms of the dynamic antagonism between the working class and bourgeoisie (Marks and Engels, 1966). Weber and Sombart emphasized the rational organization of the enterprise and the organization of work within it (different from household work and political one) as the main features of modern capitalism (Weber, 1927, p. 275-297; Sombart, 1935). Schumpeter called capitalism as a form of an economy of private property in which innovations are carried out by means of borrowed money that usually involves the creation of credit (Schumpeter, 1939).

In general, we can define capitalism as an *organizational form of industrial production*. In fact, the life of man as an individual and member of society is closely connected with the production of material goods to satisfy their needs. In addition, the material production involves the process of social reproduction (Çela and Kriqi, 1962).

Given the importance of industrial capitalism, Di Bernardo and Rullani (1990) define it as a macro-evolution consisting of two main forces:

- the exploitation of science as a productive force, that is, as a force that produces innovation;
- the competitiveness as a mean of selection and evolution of the economic, political, and cultural structures.

Indeed, capitalism became the dominant economic structure only during industrialization, which is the phase characterized by the *industrial production* of enterprise system. We speak of capitalism in an industrial optic, even to comfort in these times of crisis the *real economy* of goods and services, now suffocated by the darkness of the *symbolic economy* of money and credit, produced by the financial industry and “tricks” in Stock Exchange. Thus, according to Federico Caffè (1971), the financial suprastructure with features that presents in advanced capitalist countries favors not the virtue of competitiveness but an unscrupulous game of predatory style, operating systematically to the detriment of many categories of unprotected savers. In substance, there is a clear inconsistency between the influences of every kind that constrain the real productive activity of the various agricultural industrial sectors and commercial brokerage, and the actual license that legitimate the activity of financial markets to appropriate other people’s savings.

Necessarily, the definition of capitalism as an organizational form of industrial production is the most valid

because put in the center of the economic system the enterprise. As a matter of fact, great economists like Friedman, Hayek, Smith, Marx, and Keynes, define alternatively the capitalism as the “*free-enterprise system*” (McKinley, 2010). The initial promoters of this system have been so far two protagonists: the capitalist and the entrepreneur.

In the literature of entrepreneurship and capitalism it is often confused the role of entrepreneur with that of capitalist, using the two figures interchangeably. So, Peter Klein, in his *The Capitalist and the Entrepreneur* (2010), distinguishes between “*misesian entrepreneur*” and “*knightian entrepreneur*”. In his opinion, both types of entrepreneurs operate in conditions of risk and uncertainty. In general, Ludwig von Mises attaches an entrepreneurial function to all human actions under conditions of uncertainty, but in the case of the economic structure, for Mises, the entrepreneur and the capitalist becomes a not separated unity. Instead, for Frank Knight, the entrepreneur and the capitalist have distinct tasks and expectations in terms of risk, uncertainty, and profit. Knight’s vision is consonant with the vision of John Stuart Mill, which separates the entrepreneurial function from that of the capitalist in terms of their respective remuneration: profit for the entrepreneur and the interest rate for the capitalist (Mill, 1885). Interesting from this point of view is also the affirmation of Clark (1908, p. 3): “*free competition tends to give to labor what labor creates, to capitalists what capital creates, and to entrepreneurs what the coordinating function creates*”. Clark clearly shows that, first, the entrepreneur and the capitalist are two different subjects, and second, that the efforts and expectations of the various figures/roles within the enterprise are different. Therefore, the employee expects a salary for his work, the capitalist expects a consideration for the share capital conferred, and the entrepreneur expects a return to profit for the execution of his function as the coordinator of productive resources. Other supporters of the dichotomy capitalist-entrepreneur are Cantillon and Say, to whom are opposed Smith and Marx in an attempt to unify the activities of the capitalist and the entrepreneur. To this long debate seems to put “order” the great Schumpeter that wrote in his various works about entrepreneurship and innovation distinguishing sharply the entrepreneur from the capitalist.

Recalling Schumpeter (1939), the entrepreneur exists for the realization of innovation, which will be its output. Instead, the capitalist, as the owner of the capital, aims its reproduction. He wants to capitalize on this factor of production (i.e. the capital) that offers to the entrepreneur in exchange of shares or interest on capital, but in turn, the capitalization depends on the dynamic capabilities of the entrepreneur. If the aim of the capitalist is the multiplication of capital as an end in itself, for the entrepreneur the goal is the multiplication of innovation as an end to the survival of the business firm, considering capital and profit as instruments of progress. The entrepreneur’s profit is the reward of a successful innovation in a capitalist society and is temporary in nature: vanishes in subsequent competitive processes and adaptation (Schumpeter, 1939, p. 103).

Moreover, the entrepreneurial function is not linked to the economic risk, since it is the capitalist who bears the risk of any loss of money (Martinelli, 1994). This doesn’t mean that the entrepreneur does not run any risk; conversely, the risk is inherent in the enterprise system and is derived naturally from the business activity (McDaniel, 2002, p. 36-39; Golinelli, 2000, p.143). In other words, the entrepreneur chooses the field of production, coordinates inputs, and centralizes the risks related to the process of production. Consequently, to the capitalist is assigned a passive role in relation of exercising the business activity; he does not identify with the entrepreneurial action but with the mere operation of investment and accumulation of savings. It is instead the entrepreneur that takes the risks of procreation and business continuity. It is to him that is delegated the initiative and the animating force of industry, driving it forward with the continuous innovation processes. Logically, the risk of the entrepreneur is a risk of activities (i.e. *organizational risk*), which is the risk of assuming the responsibility for not being able to renew the business firm in front of a dynamic environment. It is obvious that the *financial risk* (the probability of loss of the invested money) supported directly by the capitalist will be included as well in the organizational risk supported by the entrepreneur, because the *organizational risk* can be considered as a macro-category that includes all the risks associated with the business activity, and it is not simply synonymous with operational risk.

As is clear from the analysis, the two figures are different by nature, although at certain times may incorporate one the characteristics of the other. In this sense, an entrepreneur can use the own capital by ignoring the role of the *ad hoc* capitalist, and the capitalist, having the capital, can use his business skills by ignoring the entrepreneur (but only in the event that has such capabilities). In this regard, one of the greatest Italian economists, Giuseppe Ugo Papi (1935, p. 105), is expressed so:

“The capitalist can also assume the risk directly, becoming an entrepreneur himself; as the entrepreneur can also use his own capital: this possibility of overlapping of the two functions does not influence, according to the different

functions, the non-separation of the class of capitalists from that of entrepreneurs. The entrepreneur acquires precise features when it is accentuated the gradual independence of the capitalist from the labor process”.

In addition, the entrepreneur over time can become capitalist. This happens, but it is not a must, when an innovation is successful in the market. In this case the entrepreneur begins to accumulate wealth closing himself and his actions in the boundaries of what was first created, not venturing more in subsequent acts of innovation; therefore, becomes a capitalist. It is more difficult to happen the opposite case, that is, that the capitalist becomes entrepreneur, because *“along with this growth, there is at the same time developed in his breast a Faustian conflict between the passion for accumulation, and the desire for enjoyment”* (Marx, 2009, p. 254).

4. Conclusions

In synthesis, the capitalist is the owner of the capital, but does not carry any social function except to finance a business that can have also social impacts. The entrepreneur, unlike the capitalist, is both an economic and a social subject. The innovation that he produces will not necessarily take place in a business organization, but may also arise in research centers, museums, sports clubs or other. In the case of non-profit organizations we cannot ignore the fact that there must be an entrepreneurial figure, and we also cannot ignore the fact that the breakeven point is to be assured. Consequently, the innovation becomes a function of an individual sociologically distinct and known as the entrepreneur (Schumpeter, 1936, p. 66). It is the entrepreneur that uses his creativity to destroy the old for creating the new (Schumpeter, 1943), to falsify the present for creating the future (Popper, 1959; Drucker, 1985), and to invent new paradigms for shifting the focus towards novelty and prosperity (Kuhn, 1962), waving through chaos and complexity up to the temporary certainty (Barile, 2011). Hence, if the capitalist has a purely economic order, recognized in capital quotas conferred and expected, the entrepreneur has, yes, an expectation of profit, but it is only the reward of successful innovation for assuring the survival of the enterprise. In other words, the capitalist is financially committed by offering the capital, expecting as a return the financial interest rate, and assuming a financial risk. Instead, the entrepreneur is committed with innovation and change, expecting the profit as remuneration for the assumed organizational risk. Figure 2 is a summary of the above reflections.

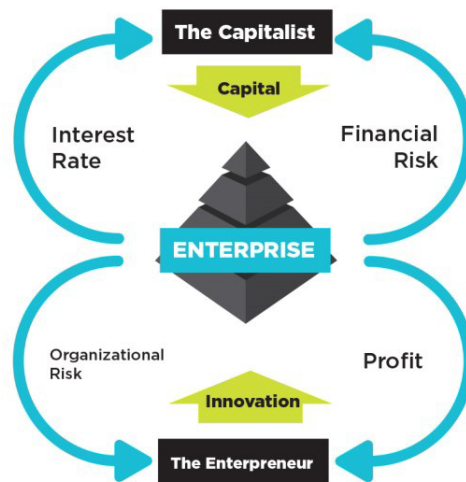


Fig. 2. Entrepreneur's and Capitalist's approaches towards enterprise

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