



Book review

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Nicolai J Foss and Peter G Klein, *Organizing entrepreneurial judgment: A new approach to the firm*, Cambridge and New York: Cambridge University Press, 2012; 299 pp., ISBN: 9780521874427, £55 (hbk).

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In *Organizing Entrepreneurial Judgment*, economists Nicolai Foss and Peter Klein successfully attempt to integrate the theory of entrepreneurship into the (economic) theory of the firm. A convenient way of delineating theories of entrepreneurship is to differentiate between those that define entrepreneurship as an outcome or a phenomenon (e.g. self-employment), and those that perceive entrepreneurship as a way of thinking or acting (e.g. innovation). Frank Knight (1921) can be classified among the latter group because he sees entrepreneurship as a particular type of action, more specifically the exercise of judgment regarding the use of resources under conditions of uncertainty. It is exactly this concept of judgment that first led to a unified treatment of the entrepreneur and the firm; Knight argued that the firm arises as an embodiment of entrepreneurship. Knight's view, however, went to the background due to the way the theory of entrepreneurship and the theory of the firm developed ever since. It is Foss and Klein who revive the Knightian view on entrepreneurship with their ambitious book.

In doing so, they adopt the functional entrepreneurship theory of Knight, in which judgment – decisive action about the deployment of economic resources when outcomes cannot be predicted according to known probabilities (p. 38) – is seen as the entrepreneurial function. In arranging heterogeneous assets to meet future needs, entrepreneurs thus bear uncertainty, and profits are to be viewed as the reward (Foss et al., 2007b). The link between Kirznerian entrepreneurship and the theory of the firm is weak, because according to Kirzner (1973), entrepreneurs only need to be alert to profit opportunities, do not own capital, and so, do not bear any uncertainty.

Since Ronald Coase's *The Nature of the Firm* (1937), the theory of the firm has three fundamental issues: the existence, the boundaries, and the internal organization of the firm. Foss and Klein (2005) link the existence of the firm to the cost of trading entrepreneurial judgment. Since judgment cannot be purchased on the market – instead, it is present in the actions of individual entrepreneurs – firms must exist for entrepreneurs to be able to carry out their function. The boundaries of the firm, i.e. the allocation of productive activities across firms, may be understood as outcomes of entrepreneurial processes of experimentation with resource combinations that arise from the entrepreneur's judgment.

Foss and Klein's most important contribution deals with the internal organization of the firm. They develop the idea of the firm as a nested hierarchy of judgment, where entrepreneurs are the source of *primary* or *original judgment*, able to delegate entrepreneurial initiatives to subordinates, referred to as *derived judgment*. Original judgment represents ultimate decision-making in the sense that the entrepreneur possesses the rights to make the ultimate decisions about the firm. This does not mean, however, that subordinates are not allowed to make decisions of critical importance to the viability and profitability of the firm. Entrepreneurship by employees within established firms may

very well contribute to, for example, process or product improvements, possibly leading to important breakthrough innovations. The judgment-based approach by Foss and Klein thus suggests that differences in firm-level performance are best explained by differences in the entrepreneurs' ability to exercise original judgment and to delegate derived judgment. Judgment has to be seen as part of a number of interrelated activities though, such as investment and hiring decisions.

The concept of derived judgment is closely related to that of *intrapreneurship*. What Foss et al. (2007a) call *proxy entrepreneurs* are those who exercise entrepreneurial activities based on delegated decision rights, while intrapreneurs not necessarily require permission by their superiors to be entrepreneurially active. In any case, the firm's optimal organizational structure encourages forms of entrepreneurial employee activity that increase firm value (i.e. *productive entrepreneurship*), while discouraging those that destroy value (i.e. *destructive entrepreneurship*), a distinction first made by Baumol (1990). The degree to which an employment relation leaves discretion to employees depends on the degree of incompleteness of labor contracts, operationalized in terms of the time that the employee is allowed to use corporate resources (including their own work time) to conduct activities that are not directly prescribed by the employer-owner (Foss et al., 2007a: 1900).

In the final chapter, Foss and Klein devote a number of pages to the implications for public policy, stressing that a sole reliance on macroeconomic theory is likely to slow the recovery from the recent financial crisis. Instead, policymakers should acknowledge that the economy is made up of heterogeneous capital resources, and thus, decentralized decision-making is the way to break from what Foss and Klein call *the shmoo view of capital*, which is the view of capital as a homogeneous mass of inputs, where there is little role for entrepreneurs and judgment. Nonetheless, the reader is provided with two straightforward implications for macroeconomic policy, essentially stating that governments should avoid public policies that generate malinvestment and a constantly changing mix of economic interventions that generate regime uncertainty. The book would have benefited from a more detailed discussion of the policy implications to be derived from the newly developed entrepreneurial theory of the firm. The authors touch upon reasons why the internal organization of the firm also involves delegated decision-making (or, derived judgment), but leave its antecedents and consequences virtually undiscussed.

In sum, Foss and Klein succeed to write a coherent and well-written book about their view on the role of the entrepreneur within the economic theory of the firm. It is a welcome elaboration of their theoretical arguments as put forward in previous work, most of the time nicely illustrated with examples. Throughout the entire book, Foss and Klein provide the reader with in-depth explanations and elaborations of different theories, which is beneficial for its readability.

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