

**Research Roundtable: Book Preview**  
*The Innovative Entrepreneur* by Daniel F. Spulber

Thursday, April 26, 2012—Friday, April 27, 2012

**Northwestern University School of Law**  
Searle Center Conference Room  
Rubloff Building Suite #542  
750 N. Lake Shore Drive, Chicago, IL

**Purpose of the conference**

The Research Roundtable will provide a book preview of *The Innovative Entrepreneur* by Daniel F. Spulber. Participants will receive a pdf copy of the manuscript and if requested a hard copy. Participants will discuss the book, offer suggestions for further study, and consider related issues regarding invention, innovation, IP, and entrepreneurship.

**Conference organizer**

Daniel F. Spulber is the Elinor Hobbs Distinguished Professor of International Business at the Kellogg School of Management and Professor of Law (Courtesy) at the School of Law, and also serves as the Research Director of the Searle Center for Law, Regulation, and Economic Growth.

**Agenda**

**Thursday, April 26<sup>th</sup>**

- 2:30 p.m.**            **Arrival Searle Center 5<sup>th</sup> Floor**
- 3:00-5:00**            **Session One: Introduction and Overview: Five Major Puzzles of Innovation and Entrepreneurship**
- Readings: Chapters 1 – 3 (Chapter 1 is sufficient)**
- Discussants:** **Simon Parker**, Richard Ivey School of Business, University of Western Ontario  
**F. Scott Kieff**, George Washington University School of Law
- 5:30-7:30**            **Cocktail Reception and Dinner**  
Devon Seafood Grill (39 E. Chicago Avenue, Chicago, IL)

**Friday, April 27<sup>th</sup>**

**8:00-9:00 a.m. Breakfast**

**9:00-10:30 Session Two: The Puzzle of Creative Destruction and The Puzzle of Innovative Competition**

**Readings: Chapter 4-9 (Chapters 4 and 8 are sufficient)**

**Discussants: David Sappington**, Department of Economics, University of Florida

**Rosemarie Ziedonis**, Lundquist College of Business, University of Oregon

**10:45-12:15 Session Three: The Puzzle of the Wealth of Nations**

**Readings: Chapters 11, 12 (can skip)**

**Discussant: Jin Li**, Kellogg School of Management, Northwestern University

**12:15-1:30 Lunch**

**1:30 Adjourn**

**Participants:**

1. **Ola Bengtsson**, College of Business, University of Illinois at Urbana-Champaign
2. **Bernie Black**, Northwestern University School of Law
3. **Shane Greenstein**, Kellogg School of Management, Northwestern University
4. **David Haddock**, Northwestern University School of Law and Department of Economics
5. **F. Scott Kieff**, George Washington University School of Law
6. **Lynne Kiesling**, Northwestern University Department of Economics
7. **Jin Li**, Kellogg School of Management, Northwestern University
8. **Kate Litvak**, Northwestern University School of Law
9. **Simon C. Parker**, Richard Ivey School of Business, University of Western Ontario
10. **Joaquin Poblete**, London School of Economics
11. **Yi Qian**, Kellogg School of Management, Northwestern University
12. **Stephen F. Reed**, Northwestern University School of Law
13. **E. J. Reedy**, Ewing Marion Kauffman Foundation
14. **David E. M. Sappington**, Department of Economics, University of Florida
15. **Daniel F. Spulber**, Kellogg School of Management, Northwestern University
16. **Arvids Ziedonis**, Lundquist College of Business, University of Oregon
17. **Rosemarie Ziedonis**, Lundquist College of Business, University of Oregon

## **The Innovative Entrepreneur**

### **Book summary**

The economic functions of innovative entrepreneurs derive from a simple fact: they are *individuals*. This endows entrepreneurs with capabilities that are fundamentally different from firms and other social institutions. Innovative entrepreneurs are creative in developing new firms, just as some individuals are creative in art, science, or invention. Individual entrepreneurs bring their unique perspectives to innovation based on their personal capabilities, experiences, judgment, and knowledge.

#### **(1) The Puzzle of Entrepreneurial Motivation: why do individuals choose to become innovative entrepreneurs?**

The Puzzle of Entrepreneurial Motivation is actually a collection of questions raised by observation of entrepreneurial behavior. The puzzle of occupational choice is based on the observation that entrepreneurs may earn less than their best alternative as an employee of an existing firm. The puzzle of investment choice is based on the observation that entrepreneurs may obtain greater returns through portfolio investment than they would from establishing a firm. This has led to suggestions that entrepreneurs derive enjoyment from entrepreneurship, behave irrationally in choosing among alternatives, or are overly optimistic about their prospects. To resolve this challenging puzzle, it may be useful to recognize that the entrepreneur obtains a collection of returns that include salary, investment returns, wealth accumulation, returns to intellectual property (IP), as well as enjoyment. These *combined returns* should be evaluated as part of the entrepreneur's life-cycle decisions to obtain a more complete picture of the incentives for entrepreneurship.

#### **(2) The Puzzle of Innovative Ideas: are inventions necessary for economic innovation?**

The Puzzle of Innovative Ideas is based on the observation that economic innovations need not involve scientific and technological inventions. The solution to this puzzle is readily obtained by recognizing that inventions also include *commercial discoveries*. Innovations that involve new forms of economic transactions, new types of markets, and new forms of organization may not be based on scientific or technological discoveries. For example, the innovative entrepreneur may develop business method inventions such as new types of electronic commerce transactions or new contractual forms. The innovative entrepreneur must develop such commercial ideas in the process of creating a new type of start-up enterprise and establishing a new type of firm. Inventions involving commercial discoveries are necessary for economic innovation.

#### **(3) The Puzzle of Creative Destruction: when are new firms necessary for economic innovation?**

The Puzzle of Creative Destruction, to use Schumpeter's paradoxical phrase, is based on the observation that entrepreneurial innovation requires costly entry and potentially destructive competition with established firms. Therefore, it might appear to be more efficient for established firms to provide all economic innovations. Established firms can internally develop inventions and introduce those inventions to the market. Even if independent inventors make significant discoveries, they can contract with established firms to introduce their innovations without the cost of establishing new firms. Establishing new firms not only involves transaction

costs but also requires costly competition with existing firms that dissipates economic returns to innovation. The resolution of this puzzle recognizes that there are many frictions in the market for inventions: standard transaction costs, imperfect intellectual property (IP) rights, imperfect transferability of complex multi-dimensional innovations, asymmetric information about inventions, and tacit knowledge of inventors. Also, existing firms may be subject to inertia that delays their adoption or development of innovations. *Market frictions* and *incumbent inertia* suggest that the returns to entrepreneurship can outweigh the returns to technology transfer. The solution to the puzzle is that under these conditions, entrepreneurship is the most efficient mechanism for economic innovation.

#### **(4) The Puzzle of Innovative Competition: how does competitive pressure affect incentives to innovate?**

The Puzzle of Innovative Competition describes a debate that has been raging for over a century: how does competitive pressure affect incentives to innovate? What I call the “Great Debate” begins with Schumpeter’s (1912, 1934) who argues that entrepreneurs stimulate innovation by establishing new firms and competing with existing firms, suggesting that competitive pressure generates innovation. However, Schumpeter (1942) later worries that the social function of entrepreneurship is “already losing importance” (p. 132); “bureaucratic administration of large enterprises tend to make innovation itself a routine matter and to substitute the activities of committees and teams of experts for individual initiative.” Schumpeter (1942) expresses concern that competition decreases incentives to innovate, advancing the hypothesis that larger firms and firms with more market power have greater incentives to innovate. The debate continues to the present generating a vast empirical and theoretical literature in economics without a satisfactory solution. Arrow (1962) shows that a monopolistic product market generates greater incentives to invent than does a competitive product market. Resolving the Great Debate is important because it has implications for practically every area of public policy, including patents, education, taxes, regulation, finance, and antitrust. I propose a basic resolution to the debate that identifies when each side’s arguments are right.

The resolution to the Puzzle of Innovative Competition depends crucially on whether or not invention and production are vertically integrated. When firms vertically integrate invention and production, competition can decrease incentives to innovate under some conditions. However, when there is a *market for inventions* – R&D and production are not vertically integrated – it is possible to identify the effects of supply-side competition among inventors and demand-side competition among producers who use inventions. Then, competitive pressure, whether it is among producers who use inventions or among inventors who provide inventions, generally increases incentives to innovate.

#### **(5) The Puzzle of the Wealth of Nations: how do innovation and entrepreneurship affect international trade and economic prosperity?**

The Puzzle of the Wealth of Nations has challenged economists at least since Adam Smith (1776) who emphasized the benefits of the division of labor across countries. Traditional economic analyses of the gains from trade generally are based on principles of static general equilibrium without innovation or entrepreneurship. However, inventors, entrepreneurs and firms increasingly compete in a global marketplace of ideas. On the supply side of the marketplace, research and development (R&D) has become global with the spread of inventive effort across a wide range of industrialized countries and expansion of invention in leading developing

countries. On the demand side of the marketplace, many companies have abandoned “not-invented-here” policies and purchase innovations produced in other countries, either through arms-length license sales or by internal transfers from foreign subsidiaries. I have shown elsewhere that invention is an important source of gains from trade as countries exchange technology in the market for inventions (Spulber, 2008, 2010). Chapter 10 shows that the quality of invention is improved by increases in the extent of the market due to international trade. Chapter 11 shows that entrepreneurship is a source of *gains from trade*, as entrepreneurs in different countries establish firms in response to global market incentives. Therefore, innovation and entrepreneurship are closely connected to international trade and make important contributions to the economic prosperity of nations.