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T. VEBLEN'S EVOLUTIONARY THEORY OF ENTREPRENEURSHIP*

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In the present paper we are analyze Veblen's ideas and arguments for the evolution of entrepreneurship and its economic effects. We begin with an analysis of his historical views of the causes and effects of the transmutation of the commercial-industrial entrepreneur into the new form of financial entrepreneur. We then explore his arguments related to the influence of credit mechanism to the promotion of new types of firms and the significant roles of the financial entrepreneurs. His business theory, noted for its negative critique, is here evaluated for its positive contributions to entrepreneurial theory and found to correlate well with recent empirical findings.

1. Introduction

V eblen used his evolutionary and holistic methodological approach in economics (see, e.g., his 1906; 1909), not only to explain the institutional functioning of the capitalist system, but additionally to shed light on some fundamental economic phenomena such as the role and functions of entrepreneurship. He developed very interesting and pioneering ideas, arguments and descriptions of entrepreneurship during the various stages of the evolution of the capitalist system, which however, did not attract the interest of the historians of economics who analyzed relevant theories (e.g., see Hebert and Link 1982; Barreto 1989; Cosgel 1996).

It is the main purpose of this paper to analyze Veblen's theory of the evolution of entrepreneurship as other aspects of his analysis on business have already been commented on[1]. In the first section, his views on

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1. For example, RAINES and LEATHERS (1993) describe the internal process of institutional development and its effect upon the formation and the function of business. O'HARA (1993) concentrates on Veblen's views of the causes of and the remedies for crises and deals with the distribution of surplus and its impact on the evolution of the system.

the causes and effects of the transmutation of the old type entrepreneur into the new type of financial entrepreneur are analyzed. In the second section, his arguments about the role of the credit system are summarized and his analysis of the actions and targets of the financial entrepreneur in promoting the consolidation of business are discussed. In the third section his theory about the function and the effects of the financial entrepreneur on the promotion of the economic system are examined.

1. From the captain of industry to the captain of finance

By adopting an evolutionary approach which recendy achieved a favourable renaissance (see, e.g., Nelson and Winter 2002), Veblen considers the processes by which a useful 'creature' such as the captain of industry, who had made a significant contribution to economic progress from the time of the industrial revolution until the middle of the 19th century, was changed into a creature industrially useless to the community.

Let us go back in time and see, what, according to Veblen, were the real and significant contributions made by the captain of industry type of entrepreneur to economic progress. The old type entrepreneur, acting by his self-interest, namely the desire for "the acquisition of property" ([1964] 1914. PP- 172-173; [1964] 1915, p. 122), contributed to economic progress because:

a) he was the proprietor and manager of the enterprise ([1975] 1904, p. 23) and the "controller of industrial equipment and resource" ([1964] 1923, p. 70);

b) he was the organizer of the industrial process ([1975] 1904, p. 35);

c) he was engaged with all financial transactions of the enterprise ([1964], p. 256);

d) his ultimate aim was to increase his profit by decreasing the cost of production ([1975] 1904, p. 23), and thus the productive capacity of the system was consequently increased ([1965] 1921, p. 30); and

e) he was a real innovator by introducing new and more productive methods of production, by introducing more serviceable goods, and by assuming the risks of his pioneering actions ([1964] 1923, pp. 102-104, 109) - an entrepreneurial innovative function already developed by A. Marshall ([1959] 1890, pp. 224-225, 234, 248) and J.B. Clark ([1956] 1899, pp. 4-5-6, 411, 425-426).

By performing all these functions, the old type entrepreneur - similar to Marshallian and Schumpeterian types (see Karayiannis 1990) - served, according to Veblen ([1965] 1921, pp. 28-29), as a fourth factor of production. In that context, entrepreneurial profits were considered ([1964] 1923, p. 104) to be a fair and justifiable reward[2].

2. Comparing the roles of innovator and financier, Veblen believed that the role of the first was the most important one for the function and development of a socio-economic system:

The Darwinian type transmutation of the old type entrepreneur not only in terminology[3] but also in functional activities occurred, according to Veblen, as a result of the following changes:

Exogenously (i.e., outside the firm): the increase in production and in population and the extended size and volume of transactions of the enterprise meant that "personal supervision of the work by the owners was no longer practicable" ([1964] 1923, p. 105); and the advance of new technology made it impossible for the entrepreneur to control and direct the production process first-hand, and thus "the oversight of the works passed by insensible degrees into the hands of technical experts" ([1964] 1923, p. 105).

Endogenously (i.e., inside the firm): the change in the process toward profit maximization, instead of relying chiefly on innovations, through preventing overproduction, and the "negotiation and maintenance of a running volume of credit" ([1964] 192.3, P- m)-

Veblen considered ([1965] 1921, p. 60; [1964] 1923, P- 106) that these changes led to the old role of the captain of industry being transmuted into two separate categories of management in the new industrial system, i.e., that of the businessman and that of the management technician (see also O'Donnell 1973, p. 208).

He emphasized that the *first type of management*, divorced from its industrial operations, is engaged in the monetary transactions of the business ([196411923, p. 108), the direction of investments to the most profitable enterprise ([1975] 1904, pp. 24-25) and in keeping the balance between different lines of the production process ([1975] 1904, p. 26). In other words, the present role of the entrepreneur is that of the financial manager ([1965] 1921, p. 4; [1964] 1923, p- 205) and the role of the captain of industry has been replaced by "the captain of solvency, investment-banker, and corporation executive of the twentieth century" ([1964] 1923, p- 257)-

The *second type ofmanagement*, that of technician, has the sole direction and control of the "mechanical process" ([1965] 1921, p. 59; see also Leathers and Evans 1973, p. 423). Veblen saw the corporate technicians as possessing the following special knowledge: a) "know the country's available resources, in mechanical power and equipment" ([1965] 1921, p. 163); b) "know and put in practice the joint stock of technological knowledge which is indispensable to industrial production" (ibid.); c) "know and take care of the community's habitual need and use of consumable goods" (ibid., pp. 163-164); and d) "it is the duty

the captains of industry "were a cross between a business man and an industrial expert, and the industrial expert appears to have been the more valuable half in their composition" ([1965] 1921, p. 33). A similar idea was also advanced by Veblen's logic teacher C.S. PEIRCE (i960, p. 87). Indeed, the relationship between Veblen and Peirce (see GRIFFIN 1998) does much to explain the positive connection of Veblen's thought with that of the classical analysis.

3. We thank an anonymous referee for this characterization.

of the technicians to plan the work and to carry it on" (ibid., p. 164). He made it clear that this knowledge of the management technicians will be used in behalf of the modern financial entrepreneur, namely:

> "[they] have continued to be employees of the captains of industry, that is to say, of the captains of finance, whose work it has been to commercialize the knowledge and abilities of the industrial experts and turn them to account for their own gain".
>
> (ibid., p. 61)

However, he did not extend his analysis to cover the technician's motive[4]. In particular, he did not explore whether the wage motive was an adequate one to compensate the technicians for the special knowledge they offered to the financial entrepreneur as outlined above. Nevertheless, he stressed that the role of the financial entrepreneur was more decisive for business than that of the technicians who were subordinates (ibid., pp. 59-60,135; [1964] 1923, p. 259). Historically, he saw the roles of Rockfeller and Carnegie as more decisive for their respective businesses of oil and steel, than the lesser important decisions of their university trained management teams educated in the new economics departments of the time.

Industrially, one of the most productive contributions of the old type entrepreneur was the innovative process. According to Veblen, in the modern industrial system, this entrepreneurial role has been entirely replaced by specialized laborers, the industrial technicians or engineers. Veblen claimed that the level of technology has advanced and exercised drastic influence on the formation of new habits of life and thought of people (see O'Donnell 1973, p. 202; Rutherford 1984, p. 331). Let us see how and under whose direction.

Veblen believed ([1964] 1923, pp. 62-63) that the stage of technology is the ultimate determinant of the productive capacity of the economic system. Although he basically ascribed ([1964] 1923, p. 63, fh. 11) technological advancement to inventions, which emerged as a result of the curiosity instinct and under the pressure of necessity[5], he emphasized the role of the captains of industry as innovators. In the modern industrial system, however, he gave priority to industrial technicians, whom he regarded ([1964] 1923, p. 255) to be the fourth factor of production, and the prime movers of innovations ([1965] 1921, p. 163). But how do inventions proceed in the modern industrial system? The main idea of Veblen is that the "art of industry" or technology is a common property. Its advancement is also determined by past knowledge as a

4. Veblen held ([1975] 1899. PP- 15-16, 2.8; [1964] 1923, pp. 115, 117) that there are material and immaterial human motives in directing economic actions, but the second are mostly determined by the first.

5. As ZINGLER (1974, p. 326) comments: "It was almost always idle curiosity rather than deliberate research which led to new knowledge and discoveries according to Veblen. Deliberate research only filled in the gaps and discontinuities in existing knowledge".

cumulative and communal process[6] - like "a joint going-concern" ([1964] 1923, p. 64) - with free circulation ([1975] 1904, p. 369; [1965] 1921, pp. 68,132; [1964] 1923, pp. 68, 262)[7]. Its prime movers are "those who live within the sweep of the industrial community" ([1964] 1923, p. 65).

Methodologically, Veblen clearly distinguished between the process of invention and that of innovation as Hobson ([1969] 1909, pp. 129-135) and Schumpeter ([1980] 1911, p. 89) also did. However, he was not convinced that the prime mover of the system was the innovative entrepreneur to the extent held by Schumpeter (O'Donnell 1973, p. 205). Veblen wrote:

> "In his capacity as business man he does not go creatively into the work of perfecting mechanical processes and turning the means at hand to new or larger uses. That is the work of the men who have in hand the devising and oversight of mechanical processes. The men in industry must first create the mechanical possibility of such new and more efficient methods and correlations, before the business man sees the chance, makes the necessary business arrangements, and gives general directions that the contemplated industrial advance shall go into effect [...] the business men in control push the advance of industry into new fields and prompt the men concerned with the mechanics of the case to experiment and exploration in new fields of mechanical process".
>
> ([1975] 1904, PP- 44-45)

In his later work ([1964] 1923), however, he held ([1964] 1923, pp. 262, 268-269), that the financial entrepreneur, by using the patent system, was able to "deflect, retard, derange and curtail the work in hand", i.e., limit the work of technicians and production. Thus "the absentee owners sagaciously exercise a running veto power over the technicians and their productive industry" ([1965] 1921, p. 165)[8].

The entrepreneurs themselves served no productive role in the advancement of technology, because as Veblen argued, "the industrial system as a working whole was failing into shape as a mechanical articulation of standard processes" ([1964] 1923, p. 265). On the other hand ([1964] 1923, p. 230), the advance of technology is carried out by the technicians, while the entrepreneurs enjoy a differential gain from its change. Thus, he wished ([1965] 1921, pp. 69,136-137) for a future where the engineers and technicians would be free to direct industry according to its productive capacity for the welfare of the community[9].

6. KNIGHT (1921, pp. 188-189, rh. 2) criticized the idea of Veblen that "the world's stock of knowledge is its most important capital, which is without value merely because not privately exploited".

7. Chandler has shown that in the beginning of the 20th century the new technology was in the main open to all businessmen (TEECE 1993, p. 212).

8. Chandler's recent research Scale *and Scope: The Dynamics of Industrial Capitalism* (1990), proved the correctness of Veblen's argument. As Chandler points out: "While the new technologies provided opportunities, it was the business enterprises and their managers that determined whether those opportunities would be converted into sustainable advantages" (TEECE 1993, p. 211).

9. For such a possibility Veblen drew some basic requirements such as class-consciousness of technicians, programming, preparation, etc. (see [1965] 1921, pp. 71,137-140,143-147,166-169).

He additionally recognized that the process of industrial innovation required experiments which entailed risks and uncertain results ([1964] 1923, p. 280); but, he did not mention who is to assume the costs of all these experiments - the technicians? or the management entrepreneurs? However, he maintained ([1964] 1923, p. 109) that the captains of finance were not such risk takers and adventurers as the captains of industry had been.

He also considered that the new class of entrepreneurs, that of financial entrepreneurs, possessed the following special characteristics compared with other economic agents.

First, the financial entrepreneurs were well fitted for "pecuniary pursuits" ([1975] 1904, p- 315).

Second, they had a "practical management of affairs" and "practical efficiency" which "means the ability to turn facts to account for the purposes of the accepted conventions, to give a large effect to the situation in terms of the pecuniary conventions in force" (ibid., p. 320).

Third, they needed special knowledge and an ability to make decisions with regard to: i) "what rate and volume of production and distribution will best serve the commercial interest of the absentee owners" ([1965] 1921, p. 164); ii) "to put this commercial knowledge in practice by nicely limiting production and distribution of the output to such a rate and volume as their commercial traffic will bear" (ibid.); and iii) "to see that the work will benefit none but the captains and their associated absentee owners, and that it is not pushed beyond the salutary minimum which their commercial traffic will bear" (ibid.).

These features enabled them to take the position of leaders of the economic system ([1975] 1904, pp. 3, 20; [1964] 1923, p. 257); thus, "the businesslike manager's attention is continually more taken up with the financial end of the concern's interests; so that by enforced neglect he is necessarily leaving more of the details of shop management and supervision of the works to subordinates, largely to subordinates who are presumed to have some knowledge of technological matters and no immediate interest in the run of the market" ([1964] 1919, p. 90).

2. Financial entrepreneurs and the consolidation of business

Veblen emphasized that the entrepreneur, by increasing the turnover of capital increases his profits - an argument developed mostly by Marx ([1959] 1894, pp. 70-72). Veblen recognized ([1975] 1904, pp. 93-94) two means by which the capital turnover is increased: by adopting a more efficient, time-saving industrial process through innovations, and by more effective salesmanship, namely through "publicity (advertising), and personal bargaining" ([1964] 1923, p. 311). He relatively observed that, instead of the first instrument, the majority of entrepreneurs pre-

ferred to achieve the same results by an alternative, i.e., by increasing the use of credit, or to "increase his liabilities and to discount his bills receivable" ([1975] 1904, p. 95).

He departs (1903, pp. 104-105) from the traditional view put forward by Laughlin (1903, pp. 7-9,17) - however, without quoting his name - that, by using credit the productive capacity of economy is increased, and the service of loan credit is only to transfer capital from one to another agent. He counter-argued that credit mechanism not only has an extensive and cumulative character ([1975] 1904, pp. 104-107), but additionally cause a redistribution of wealth (ibid., p. 109) and increase the class of absentee ownership (ibid., pp. 109-113)[10]. Other consequences of the extension of credit to business are: a competitive search for differential gains, and a customary practice for all credit users (ibid., pp. 96-97-104-105).

For Veblen the extension of credit and the emergence of new 'financial products' and practices were instruments for the consolidation of business which however became possible through the advance of technology. Namely, the industrial technicians, i.e., "the inventors, engineers, experts", prepared the way for the consolidation of the enterprises, achieving economies of scale and increasing the scope of production (ibid., p. 36). He explains in a relate manner that business coalitions "have resulted in a great economy of production, and that the failure to carry these coalitions farther means an annual waste running up into the millions" (ibid., p. 41, fn.). Moreover, he was well aware of the law of increasing returns in large scale production processes ([1964] 1923, pp. 306-307). Then, again, functionally, scale is what scale does and large and small are simply relative variables in the constant striving for greater industrial efficiency[11].

Veblen described the specific genesis of corporations from the successful private firms or partnerships (ibid., pp. 140-141). Incorporation is established through the extension of credit and the capitalization of funds. A corporation's ultimate end is "business transactions of the nature of bargain and sale" ([1964] 1923, pp. 82-83), which results in "larger net gains to be got by a more exhaustive use of credit" (ibid., p. 84) and an increase in salesmanship (ibid., p. 83). Thus, he emphasized

10. Veblen ([1965] 1921, pp. 156-157; [1964] 1923, pp. 12,353) gave a very broad definition of absentee ownership, not only covering the pure capitalists, but the ownership of any property that is not directly produced by the proprietor. He also mentioned ([1965] 1921, pp. 162-163) that the absentee ownership and profiteering were accepted by Americans as a way of life and thus were difficult to change. Thus he was well aware that culture is an influential factor of the way that entrepreneurship is exercised (for such influences on entrepreneurship see KARAYIANNIS 1996).

11. Chandler, too, argues, as Veblen does, that: "The critical entrepreneurial act was not the invention - or even the commercialization - of a new or greatly improved product or process. Instead, it was the construction of a plant of the optimal size required to exploit fully the economies of scale or those of scope, or both" (quoted by TEECE 1993, p. 201).

(ibid.) that the manager of the corporation directly controls the financial activities of the company, while he indirectly regulates the volume of production.

He specified ([1975] 1904, pp. 141-142) that the corporation, emerged in those sectors of the economy where it was possible to merge and to exploit monopolistic elements. However, he leaves undetermined and unexplained the activities which established those differential advantages. Although he does note emphatically that relative "good-will" accompanies the formation or progress of a corporation, viz:

"When a corporation begins its life history without such a body of immaterial differential advantages, the endeavors of its management are early directed to working up a basis of good-will in the way of trade-marks, clientele, and trade connections which will place it in something of a monopoly position, locally or generally" .

(ibid., pp. 142-143)

The "economy of production", as he argued, brought about by the consolidation of business engineered by the financial entrepreneur, was achieved through the following "savings":

1) "a saving of the cost of business management" (ibid., p. 46). This, "is a saving of work and an avoidance of that systematic mutual hindrance that characterizes the competitive management of industry" (ibid., p. 48).

2) a saving "of the competitive costs of marketing products and services" (ibid., p. 46).

3) "The amount of business that has to be transacted per unit of product is much greater where the various related industrial processes are managed in severalty than where several of them are brought under one business management" (ibid.). And, "It is in doing away with unnecessary business transactions and industrially futile maneuvering on the part of independent firms that the promoter of combinations finds his most telling opportunity" (ibid., pp. 47-48). Most likely, he would have welcomed our modern age of computer technology-

Veblen makes clear (ibid., p. 49) that in the majority of cases the promoters of consolidation have not only the above advantages in mind, but likewise their pecuniary gain through financial maneuvering. Thus, the promoter of business consolidation, the financial entrepreneur, directs his actions toward increased selling at the most profitable price by advancing advertising and not primarily the serviceability of products (ibid., p. 51)[12]. For Veblen, the ethical lodestar of economic thought is serviceability to the community. Correlatively, the

12. The role of advertising has been particularly analyzed later on by CHAMBERLIN (1933, pp. 118-120) who admitted such a similarity with Veblen in a letter to J.M. Clark dated July 30,1958 (quoted in FIORITO 2000). We thank an anonymous referee for such a notice.

efficiency of any economic system is measured by the excess of its serviceability over its cost to the community. This raises the question of how vendibility of products can be increased if its serviceability does not stand on good grounds. Or to put it differently, in what way will the vendibility of a product be increased? Veblen's emphatic answer for our corporate state is via advertising. A promising advertising campaign, however, not only depends on the good advertising expert; it also depends to some extent on the qualities or special characteristics of the product which will satisfy the needs of consumers more adequately than those of other goods. The features of the product may also increase its utility to consumers. Although he recognized the necessary differentiation of products in terms of quality and other characteristics, he did not extend his discussion into the narrow issues of consumer economics, although he had introduced ([1975] 1899, pp. 48-49) the role of a conspicuous consumption attitude and behavior. He rather preferred to stress negative features of advertising and the vendibility of goods. Yet, in a more sober moment, he recognized that "the brute serviceability of the output of these industries may be a large factor in its vendibility, perhaps the largest factor; but the fact remains that the end sought by the business men in control is a profitable sale, not to the end that the way of life may be smoother for the ultimate consumer of the goods produced" ([1975] 1904, p. 62). Thus, he admitted that capitalism has a survival potential at some historical, yet undetermined, level of serviceability to the world's community.

Veblen considered ([1965] 1921, p. 219) that the capitalized value of a corporation is related to its earning capacity, which is directly determined by the goodwill ([1964] 1923, p. 221, m. 12) and the market rate of interest. Capital is related not only to material equipment or its costs, but also to the earning capacity of the capitalized tangible and intangible assets ([1975] 1904, pp. 89-90, 135-138, 153)- The earning capacity of enterprises is increased by enlarging the difference between price and cost through employing the following management techniques: by the curtailment of output or "sabotage" ([1965] 1921, pp. 4, 7); by decreasing the rate of wages ([1964] 1923, p. 220); and by increasing firstly the vendibility and, secondly, the serviceability of goods produced with the help of capital ([1975] 1904. P-153)[13]-

He clearly emphasized (ibid., p. 153, fn.) that the earning-capacity is increased when the profit of capital is larger than the market rate of interest, because capitalization is derived by dividing the annual income by the interest rate. Thus, the main factor determining the value of capital is the rate of profit. He stressed (ibid., p. 88), that entrepreneurs calculate a rate of ordinary profits on the basis of which the

13. For an extensive analysis of Veblen's theory of capital see GRIFFIN (1991)-

earning capacity of the enterprises is estimated[14]. In line with this established ordinary rate of profits, entrepreneurs recognize "brisk times", i.e., when the market rate of profit is higher than the ordinary, and "dull times", i.e., when the market rate of profit is less than the ordinary (ibid., p. 89); while a zero rate of profit is one that is equal to the market rate of interest (ibid., p. 218).

However, he considered that the most significant elements in an entrepreneur's schedule for increasing the earning capacity of the enterprise, is the capitalized value of intangible assets and mainly the goodwill of the firm, viz:

> "It is upon this factor of good-will in capital that a change in presumptive earning-capacity falls most immediately, and this factor shows the widest and freest market fluctuations".
>
> (ibid., p. 154; see also p. 138)

He then held that the earning capacity of a modern firm is much higher than the earning capacity of its material equipment because of the element of intangible assets. This difference in the rate of earning capacity he attributed (ibid., p. 138) - although not emphatically - to some actions of the entrepreneur which result in a formation of'goodwill' in the enterprise. As he argued (ibid., pp. 173-174), the goodwill which a manager creates in an enterprise will accompany his name as it happened with Carnegie (ibid., pp. 172-173). In the case where the entrepreneur will change his business, and in the case where he will start a new one, this goodwill will be capitalized. Veblen denned goodwill as follows:

> "Good-will taken in its wider meaning comprises such things as established customary business relations, reputation for upright dealing, franchises and privileges, trade marks, brands, patent rights, copyrights, exclusive use of special processes guarded by law or of secrecy, exclusive control of particular sources of materials. All these items give a differential advantage to their owners, but they are of no aggregate advantage to the community. They are wealth to the individuals concerned - differential wealth; but they make no part of the wealth of nations"
>
> (ibid., p. 139)[15]

14. Veblen considered that total profits "will tend to coincide with the net product of the industrial system" ([1964] 1923, p. 61), and will be equal to the difference between the output of the industrial system and its cost, "counting cost and output in physical terms" (ibid.). Also, he defined ([1965] 1921, p. 13) reasonable profit satirically as "the largest obtainable profit".

15. Veblen gives an additional definition of goodwill particularly in the case of the financial entrepreneur. He alleges that goodwill "in this field [i.e., the financiers and the financing firms] of enterprises most frequently takes the form of a large ability to help or hinder other financiers and financing houses in any similar manoeuvres in which they may be engaged, or an ability to put them in the way of lucrative financing transactions" ([1975] 1904, p. 171, fh. 1; brackets added). However, in his "On the Nature of Capital" (in *The Place of Science in Modern Civilization)* he gives a narrower definition in goodwill by excluding "patents, copyrights, and franchises, which he then includes in another specific class of intangible assets" (ENDRES 1985, p. 639). Some of those elements of the Veblenian goodwill were adopted by HOTELLING (1929, pp. 470-471) in analyzing spatial competition and later on by CHAMBERLIN (1933, ch. IV) in his justification of product differentiation as the main source of monopolistic competition.

He reasoned that the actions advancing goodwill could be distinguished from other specific entrepreneurial actions as follows:

First, some of the elements of goodwill are produced by the proper behaviour of the entrepreneur toward his customers and suppliers. He made it clear that in the old days or with small firms where the entrepreneur was obliged to have immediate connections with his consumers, the personal contact in terms of "reputation of workmanship" and a low "degree of irritation and ill-will" (ibid., p. 52), was of prime importance for the vendibility of goods. In contrast, he held (ibid., p. 53) that the managers of the firm have no real personal contact with the consumers in the modern industrial system.

Second, some elements of goodwill are formed by the innovative activity of the entrepreneur (by himself or under his direction), building cumulatively to a monopolistic (although short-run) privilege- an idea developed later on by Sraffa (1926, pp. 190-191).

Third, some elements, perhaps, will be the result of special knowledge and information that the entrepreneur possesses about the function of the market or a special source of materials[16].

In the age of the large corporation, verified by Means (1962, pp. 16-17), Veblen maintained ([1975] 1904, p. 90), that entrepreneurs act with the aim of increasing the earning-capacity of their capital; not by increasing the volume of product of their corporation. The money value of the corporation thus is determined by three conditions, one of which results from the actions of the manager or entrepreneur: by "the tone of the market"; by "the manoeuvres of the business men to whom is delegated the management of the companies"; and by "the accidents of the seasons and the chances of peace and war" (ibid., p. 148). Leaving aside the first and the last conditions which are general for the whole economy, the second condition, regulated by the entrepreneur, is the most decisive.

For Veblen, "in the capital market the commodity in which trading is done, then, is the capitalized putative earning-capacity of the property covered by the securities bought and sold" (ibid., p. 155). In this way, the managers who know exactly the actual earning-capacity of their corporations are able to speculate in the capital market and to gain from any difference between the "putative earning-capacity" and the "actual earning-capacity" of the corporate market value; i.e., the price of stocks and securities in the capital market (ibid., p. 155). Thus, the managers are trying to increase the "putative earning-capacity" at a faster rate than the corporate "real earning-capacity" in order to "sell

16. VEBLEN ([1975] 1904, p. 140, fh. 1) dismissed the argument of F.A. WALKER (1887, pp. 273,275, 288) - however without mentioning his name - that all these differential advantages accruing to the businessman justify a kind of rent reward. For the rent-of-abilities theory of entrepreneurial profit see KARAYIANNIS (1990, p. 253).

the securities of the concern with advantage to themselves" (ibid., pp. 156-157)[17].

In earlier times, as he observed, there were no major differences in the community interests of managers, consumers and the enterprise. But, in the modern or credit economy, as he argued:

> "the interest of the community at large demands industrial efficiency and serviceability of the product; while the business interest of the concern as such demands vendibility of the product; and the interest of those men who have the final discretion in the management of these corporate enterprises demands vendibility of the corporate capital".
>
> (ibid., pp. 157-158)

Thus,

> "the interest of the men who hold the discretion in industrial affairs is removed by one degree from that of the concerns under their management, and by two degrees from the interests of the community at large".
>
> (ibid., pp. 158-159)

Thus, he maintained that the actions of corporate managers have different consequences for them, for the customers and for the corporation as a going-concern. This is particularly the case when their actions are directed toward raising the "putative earning-capacity" of the corporation above its "real earning-capacity". In other words, he held that the managers of the corporation "manage the affairs of the concern with a view to an advantageous purchase and sale of its capital rather than with a view to the future prosperity of the concern, or to the continued advantageous sale of the output of goods or services produced by the industrial use of this capital" (ibid., p. 157). The managers can do so, Veblen reasoned, because in general the intangible value of capital is larger than the tangible one, and the managers have not any real property at their disposal.

It seems, however, that the interests of corporate managers are not nearly as diversified as Veblen, often with tongue-in-cheek, may appear to be arguing. He also admitted that the most important determinant of the "vendibility of the corporate capital" or of the "putative earning-capacity of the corporate capital", is the vendibility of the products or services of the corporation which, in their turn, are functions of the serviceability of the products and services. Thus, there can be a direct connection, and perhaps to a much larger extent than recognized by Veblen, between these three supposedly different interests.

17. He also noted that the manager is able to speculate in the capital market by mis-managing the enterprise in order to lower "the putative earning capacity of the concern below its real earning capacity and so will afford an advantageous opportunity for buying with a view to future advance or with a view to strategic control" ([1975] 1904, p. 161).

From the above analysis it seems that he described a logical progression of the firm and of industry in three stages: 1) basic industry servicing a community; 2) industry expanded with business interest and sales; and 3) transformation to a corporate enterprise and sale of corporate capital.

The question whether Veblen was a forerunner of the idea of the separation of ownership and control in business developed by Means (1931) and Berle and Means (1932) has recently been given a good deal of attention by commentators[18]. Let us consider Veblen's position in this respect:

He seems to see a relationship between common stock, intangible assets and managers, on the one hand, and preferred stock, tangible assets and owners, on the other hand. This distinction is a formal one, drawn for theoretical reasons. He comments: "It may be argued that this identification of the common stock with the intangible assets holds true in theory only" ([1975] 1904, p. 147, fn. 1). He uses (ibid., pp. 146-147 and fn.) such a theoretical distinction in order to show that the managers of a corporation, having no real property, are merely the captains of the corporate ship. Persons having real property have no immediate part in the rather daily decision-making process of the corporation. As he comments: "modern business enterprise takes the corporate form, is organized on credit, and therefore rests on absentee ownership; from which it follows that in all large-scale business the owners are not the same persons as the managers, nor does the interest of the manager commonly coincide with that of his absentee owners, particularly in the modern big business" ([1965] 1921, pp. 125-126). Moreover, he needs to justify his argument that the managers are those who established the intangible assets and goodwill of the firm. They are therefore, the real controllers of those assets.

As he makes clear ([1975] 1904, pp. 146-147, fn.) in most cases involving corporate holdings, the nominal value of intangible assets or common stock is larger than the nominal value of real capital and preferred stock. Thus, as the goodwill accrues to an earning capacity larger than the earning capacity of the real capital (equipment, etc.) of the organization, it seems evident that the entrepreneur or manager whose holdings of common stock include such intangible assets, will try to increase the value of his holdings by increasing the goodwill and therefore the value of the common stock. This particularly occurs in the formation of holding companies which historically arose because of the incentive to conduct "safe and sane business" ([1964] 1923, p. 334)[19]-

18. LEATHERS and EVANS (1973, p. 425; 1980, pp. 443-444) argue that Veblen anticipated Berle and Means with regard to separation between management and ownership in the historical evolution of the corporation. On the other hand, WALKER (1977, p. 223) and RUTHERFORD (1980, p. 440; 1981, p. 157), show that Veblen did not attach the same meaning to such separation as Berle and Means.
19. Veblen accurately described the various causes for the establishment of holding companies ([1964] 1923, pp. 334-338) and the reorganization of business through various coalitions (ibid., pp. 342-343).

The establishment of these companies separates the owner from the manager, for the owner cannot regulate the management as he wishes (ibid., pp. 331-332). Thus, Walker (1977) and Rutherford (1980; 1981) have a point when they comment that Veblen did not clearly anticipate the distinction between the managers and owners of the corporation of the Berle-Means type. Although this distinction has long been known (see, e.g., Simpson 1919, pp. 154-155; J.M. Keynes 1926, pp. 289-290), it seems that the Berle-Means theory of the corporation was an institutionalist elaboration that owed much of its inspiration to the work and thought of Veblen.

3. **Other functions of the financial entrepreneur**

As we mentioned in the first section of the paper, according to Veblen, the influential changes of technology, population, business goals, and historical conditions in the genesis and evolution of business enterprise, have gradually developed into distinctive roles for business technicians and financial entrepreneurs.

The new type of entrepreneur, as he explained, is that of financial director of the system, viz:

"Entrepreneur is a technical term to designate the man who takes care of the financial end of things. It covers the same fact as the more familiar business man, but with a vague suggestion of big business rather than small. The typical entrepreneur is the corporation financier"

([1965] 1921, p. 29, see also p. 33)

The ultimate objective of the new type of entrepreneur is the same as that of the old captain of industry: the maximization of profits. However, the path which the financial entrepreneur takes toward the attainment of this aim is different from that of the old captain of industry. As Veblen argued ([1975] 1904, pp. 36-37), the financial entrepreneur, by introducing the consolidation of business, tries to maximize his monetary gains not through innovative actions, but primarily by exploring the economies of production and by using his financial power to his advantage. He maintained ([1965] 1921, p. 38) that the specific process by which the financial entrepreneur, or the corporate manager, maximizes his profits is by the curtailment of output and by increasing salesmanship in "what the traffic will bear". He really believed that the financial entrepreneur would produce and sell at "what the traffic will bear"[20], which was a function of product volume and price,

20. Veblen explained that what "the traffic will bear" means that "prices are fixed by consideration of what scale of prices will bring the largest aggregate net earnings, due regard being had to the effect of a lower price in increasing sales as well as to the reduction of cost through the increase of output" ([1975] 1904, p. 258).

with managers regulating the volume and thereby indirectly determining the price ([1964] 1923, p. 388, fh. 28) at a level that maximizes profit (ibid., p. *67).* He additionally held (ibid., pp. 287, 299) that the main strategy of competition is not exercised through the diminution of prices, but by the increase of salesmanship through advertising - a relevant argument set forth at the same time by J.M. Clark (1923, pp. 28-29, 62). Also, Veblen argued ([1964] 1923, p. 287, fh. 2) that the cost of production in the modern industrial system is mainly reduced by a diminution of the rate of wages and not by introducing new methods of production.

As he observed ([1975] 1904, p. 35), during the last decades of the 19th century the role of the entrepreneur in the formation of large industrial consolidations was useful to the community, because of his "heightened serviceability and economies of production". But at the beginning of the 20th century, as the opportunity for gains had been advanced and their source had been changed, he stressed (ibid., p. 24) that the functions of the entrepreneurs had also changed in the following grounds:

1) They had become the financial controllers of the system (ibid., pp. 18-19,27) until their place would be taken over in the future by a monied class of bankers. Thus, in our era, the captains of finance have given up their place to the investment banker ([1965] 1921, pp. 45-48, 66-67; see also Griffin 1982, p. 26), who is able to increase the extension of credit and the value of intangible assets (Veblen [1964] 1923, pp. 339-340,348)[21].

2) They are the promoters of the consolidation of business ([1975] 1904, pp. 121,128) and the distributors of the absentee ownership (ibid., pp. 128-130).

3) "They are experts in prices and profits and financial maneuvers; and yet, the final discretion in all questions of industrial policy continues to rest in their hands. They are by training and interest captains of finance; and yet, with no competent grasp of the industrial arts, they continue to exercise a plenary discretion as captains of industry" ([1965] 1921, p. 40).

4) The interest of the financial entrepreneur who wishes to continue his enterprise is to achieve some differential elements in his enterprise and/or product which would increase his monopolistic power, namely:

21. Veblen noticed ([1965] 1921, p. 45), that in "the Era of the Investment Banker", the more "inclusive this financial organization is, of course, the more able it will be to manage the country's industrial system as an inclusive whole and prevent any hazardous innovation or experiment, as well as to limit production of the necessaries to such a volume of output as will yield the largest net return to itself and its clients" (ibid., p. 48). However, as Chandler has shown, the investment bankers did not play a decisive role in the large American corporations (TEECE 1993, Pp- 204-205); but, then again, the elite corporate owners have played decisive roles in founding investment banking dynasties down to the present.

"to establish as much of a monopoly as may be [...] a legally established one, or one due to location or the control of natural resources, or it may be a monopoly of a less definite character resting on custom and prestige (good-will)".

([1975] 1904, pp. 54-55)

And,

"the end sought by the systematic advertising of the larger business concerns is such a monopoly of custom and prestige. This form of monopoly is sometimes of great value, and is frequently sold under the name of good-will, trade-marks, brands, etc.".

(ibid., p. 55)

What have been the consequences of these functions of the financial entrepreneurs according to Veblen?

First: He makes it clear ([1965] 1921, pp. 38, 42, 62) that the financial entrepreneur is mainly interested in controlling and curtailing the volume of production; not in increasing its productivity and volume[22]. In other words, the aim of the financial entrepreneur or the manager of a corporation is to advance sales without increasing production, and to diminish costs through an increase in productivity, something which runs counter to the general welfare ([1965] 1921, pp. 119-121)[23]. Competition in the modem industrial system, for Veblen ([1964] 1923, pp. 78, 98), is conducted on the basis of sabotage (i.e., in the curtailment of output) and through ever more intense salesmanship[24], and not by reducing the cost of production through innovations (ibid., pp. 94, 97, 390, 420). Still, he noted that: "The competitive use of funds may, though it need not, involve a competitive increase of the production of goods" (ibid., p. 94).

It seems that Veblen's analysis with regard to the curtailment of output in order to have the earning capacity of the enterprise increased, has validity only if the following circumstances are taking place: all the major enterprises in a market for specific goods are doing the same, none of the existing representative firms is trying to increase its market share by increasing the volume of sales, and none of the significant firms is willing to increase its goodwill in the market. Moreover, Veblen's argument could only be valid for well established firms and not necessarily for newly established ones. The argument acquires validity when large corporations prevail in the economy. In such a case, as

22. Similarly, MEANS argued (1962, pp. 18, 92-93) that, on the one hand, by regulating the volume of production directly, corporations fixed the prices and reduced their flexibility. On the other hand, the strategy of corporations is formulated in terms of the regulation and curtailment of the level of production.

23. As Veblen maintained ([1965] 1921, pp. 106-107) this scope of the manager of a corporation is a major cause of another conflict of interest between him, the laborers and the consumers.

24. Salesmanship for Veblen, "is the art of taking over a disproportionate share of this run of sales, at a profitable price" (1923, p. 287); a realistic accounting of the fact, but not the most unbiased evaluation of the salesman's responsibility.

Veblen mentioned, the system is managed "by businesslike methods for businesslike ends", and there are four kinds of "waste and obstruction": "(a) Unemployment of material resources, equipment and manpower, in whole or in part, deliberately or through ignorance; (b) Salesmanship...; (c) Production (and sales-cost) of superfluities and spurious goods; (d) Systematic dislocation, sabotage and duplication, due in part to businesslike strategy" ([1975] 1921, p. 108).

Second: the manager of the corporation increases the wasted resources of the system by promoting salesmanship techniques ([1964] 192.3, p. 107). Veblen recognized that "advertising is a service to the community" ([1975] 1904, p. 57), when its purpose is to diminish the ignorance of the consumer in regard to his purchasing possibilities for various goods. However, he stressed that most advertising is competitive and attempts "to establish a profitable popular conviction" (ibid., p. 55); therefore, it causes a waste of resources and an increase of prices through the inclusion of its cost in the price of goods (ibid., p. 58; [1964] 1923, pp. 300-301,303)[25]. This kind of competitive advertising habit generalizes to a level of custom as "each concern must advertise, chiefly because the others do" ([1975] 1904, p. 58).

Third: the corporate manager through salesmanship techniques creates new needs for the consumers, but these needs are not necessarily required for living ([1964] 1923, p. 108). What happens can best be described as increasing the rate of conspicuous consumption among consumers.

Fourth: the financial manager is able to disturb the system to his own advantage, achieving pecuniary results which do not coincide with those of the rest of community ([1975] 1904, pp. *xj-i^f*. The financial entrepreneurs, according to Veblen, having some funds at their disposal, are seen to be establishing a business in a part of the system or "gaining control of some large portion of the industrial system" (ibid., p. 30) with two different aims in mind: one is to facilitate the smooth operation of the system (ibid.); and the other, to disturb it, namely: "his efforts are directed, not to maintaining the permanent efficiency of the industrial equipment, but to influencing the tone of the market for the time being" (ibid., p. 31).

25. Veblen analyses advertising in the content of "a propaganda of faith" ([1964] 1923, *Note to Chapter XI,* pp. 319-325). The most successful advertising, according to Veblen, is of goods which are directly related to "the personal well-being or the personal prestige of the consumer" (ibid., p. 309), i.e., with conspicuous consumption goods, while the salesman is trying to persuade the consumers that a good is useful (ibid., p. 302).

26. KNIGHT (1921, p. 334, fh.) questions this idea of Veblen in regard to the disturbing role of the financial entrepreneur and comments that, "Veblen's allegation that such stealing through the production of disturbances in business arrangements is the usual or characteristic activity of modern economic life is of course merely humorous". Knight's view was of little comfort to those who lost in the depression of 1929; and, again, to the impoverished employees of Enron corporation in 2001-2002.

However, the way the entrepreneur will "upset or block the industrial process at some one or more points" (ibid.) is not enumerated by Veblen. His only point is that the entrepreneur's strategy "is commonly directed against other business interests and his ends are commonly accomplished by the help of some form of pecuniary coercion. This is not uniformly true, but it seems to be true in appreciably more than half of the transactions in question" (ibid., pp. 31-32). Thus the most common way of disturbing the system, according to Veblen, is through the establishment of an industrial coalition which will make it "difficult for the plants or processes in question to be carried on in severalty by their previous owners or managers" (ibid., p. 32), that is, by "the invention and organization of difficulties designed to force rival enterprises to come to terms" (ibid., p. 32, fh. 1). Therefore, as he stressed, the entrepreneur gains advantage in purchasing and directing a portion of the industrial system not by any innovation or as a result of possessing special knowledge and information; he does so through his monetary power. Innovation and new technical knowledge are attributed to the engineers, technicians and lay community. In other words, he describes the actions of a businessman who already owns money capital and he uses it to disturb the monetary values of the industrial system in order to gain control of part of it. A point missing in his analysis here is the lack of an explanation of the means by which the financial entrepreneurs gain their capital. Is it by heritage or the previous successful establishment and direction of a firm? or can it be arbitrary, subject only to socioeconomic conditions? In other words, Veblen analyzes the actions of a man whose advantages come with his existence and accumulate with other members of a new monied ruling class.

Fifth: By increasing the goodwill and the credit possibilities of the enterprise, the financial entrepreneur is able to increase his differential gain out of which savings higher than would otherwise be the case emerges, which, in turn, increase the monetary capital and the monetary wealth of the economy (ibid., pp. 168-169, fn. 2). However, as he makes clear (ibid.), the establishment and the promotion of the goodwill of an enterprise do not necessarily constitute a productive contribution. Thus, the profits of businessmen (or part of it) are income withdrawn from the other productive agents.

From the above analysis of the functions of the modern financial entrepreneur, it seems that Veblen held that they were not harmonized with the general welfare of the community. He justified (ibid., pp. 61, 63-64) his view by reasoning that the new function of the financial entrepreneur is not as productive as that of the old captain of industry; while its reward is an income withdrawn from the productive agents.

In his comparison between the productive (in introducing economies through business consolidation) and the unproductive (in establishing a coalition of business) contributions of the financial entrepreneurs, however, he stressed the increased efficiency in labor utilization which the modern entrepreneur is able to achieve because of his ability to organize workers. As he noticed:

> "the management of industry by modern business methods should involve a large misdirection of effort and a very large waste of goods and services, it is also true that the aims and ideals to which this manner of economic life gives effect act forcibly to offset all this incidental futility. These pecuniary aims and ideals have a very great effect, for instance, in making men work hard and unremittingly, so that on this ground alone the business system probably compensates for any wastes involved in its working [...]. It makes up for its wastefulness by the added strain which it throws upon those engaged in the productive work".
>
> (ibid., p. 65)

Here, Veblen was rather ironical in arguing that an increase in work efficiency has resulted from the better organization of the production process. It is this efficient utilization of labor, more than the increase of the consumptive needs (artificial or real) of laborers in the state of an "affluent economy", as the latter is described by Galbraith ([1969] 1958), that has advanced our standard of living. On this point, Veblen succeeded in his prognostication, as Chandler recently showed that by the "coordination and control, exercised through organizational structures and systems designed by management" the economies available in new industries have been captured (Teece 1993, p. 201).

Veblen recognized that enterprises face some risks which are mostly generated by the manipulations of the managers. These risks are different from the risks from uncertainty which had been developed as a function ofentrepreneurship by such authors as Cantillon, Hamilton, and Knight (see Karayiannis 1992). However, he held that the managers do not customarily assume such risks; they are mostly borne by those who own the tangible assets of the corporation, or the real capitalist investors- an idea similar to that of Schumpeter ([1980] 1911, pp- 75, 137)- Veblen ([1975] 1904, p. 167) justified his argument on two grounds: the managers own less real or tangible property of the corporation; and they know about the manipulation which they have undertaken and the accompanying risks. Consequently, they do what they can to avoid bearing such risks. However, in times of a business depression, he maintained, a reward to the entrepreneurs is justified, for they bear some risks for which they are not the cause, namely:

> "If the interval between the inception of the new enterprise and its completion is a long one, the situation may so change in the meantime as to leave it unprofitable even if it has been conservatively planned".
>
> ([i975] 1904, P- 219)

As we have seen, according to Veblen, the evolution ofentrepreneurship not only in terminology but also in function, encompasses three stages: (a) pure energetic entrepreneur or captain of industry; (b) financial entrepreneur; and (c) investment banker[27]. However, in regard to the last type of entrepreneurship, that of the captain of finance, the 20th century began to give way to another special personality. At first, his financial duties through the increase in the organization of the firm and the increase in specialization were assumed by clerks; then, his duties in controlling the output were superseded by specialists. He thus became the chief of business or a social bureaucrat:

> "The new move is of a twofold character: (a) the financial captains of industry have been proving their industrial incompetence in a progressively convincing fashion, and (b) their own proper work of financial management has progressively taken on a character of standardized routine such as no longer calls for or admits any large measure of discretion or initiative. They have been losing touch with the management of industrial processes, at the same time that the management of corporate business has, in effect, been shifting into the hands of a bureaucratic clerical staff'.
>
> ([1965] 1921, p. 41)

The new system of corporate enterprise, accompanied by its dynastic corporate state, is transformed from the old social economy by the entrepreneur's evolution into the new financial entrepreneur; and, then, into an investment banker[28]. But, as Veblen observes ([1965] 1921, p. 130), the system has some weaknesses or defects. Mainly, the entrepreneurs are under the direction of vested financial interests, and a monetary dynasty develops ([1965] 1921, p. 149).

Conclusions

In his works, Veblen provides a general analysis of the evolution of entrepreneurship besides the evolution of the capitalist system from the times of the Industrial Revolution until the early decades of the 20th century. He mainly analyses the modern function of an already established business entrepreneur, whose main function is to promote the consolidation of various firms (merger) and the establishment of a large corporation. To this end, he uses the various new forms and institutions of credit and finance. But all this takes us far from the way in which the entrepreneur was originally established in his own business.

27. As Veblen noticed: "This captain of industry, typified by the corporation financier, and latterly by the investment banker, is one of the institutions that go to make up the new order of things, which has been coming on among all the civilized peoples ever since the Industrial Revolution set in" ([1965] 1921, p. 31).

28. As RAINES and LEATHERS (1993, p. 263) comment: "Veblen's analysis of evolutionary changes in financial institutions within the modern business enterprise system clearly reveals how a process of endogenous institutional change occurs under the impulse of individual pursuit of pecuniary gain on the part of businessmen/financiers. It also demonstrates that while the results yielded benefits to the large businessmen/financiers as their self-interested actions intended, there were also unplanned results which tended to expand and stabilize the financial system under the collusive control of the large banking houses". But when the collusive control of the banking houses fails, as had happened, as Raines and Leathers surely know, during the depression of 1930-1931, stability had to be developed through government financial resources and planning. J.P. Morgan and friends could not provide the financial resources needed to rescue and stabilize the larger economy as they last did in 1907-1908 (see WALTON and ROCKOFF 1990, pp. 412-413, 485-486).

Veblen is also not clear as to why financial entrepreneurs choose ways such as the consolidation of the firms to gain advantage and not the introduction of a special innovation. On the other hand, he seems to hold that the financial entrepreneurs are using new technology, not only by following the actions of their competitors, but also for the following reasons: a) they are able to replace labor with capital and are then in a better position *vis-a-vis* trade unions; b) they are able to decrease the level of cost; and, at an unchanged price, are then able to increase their profits, particularly when they are producing key products; c) they are able to increase unemployment, and are then in a better bargaining position vis-a-vis the trade unions, particularly in the matter of decreasing the wage rate. For Veblen ([1964] 1923, p- 290), workers are often unable to increase the wage rate because entrepreneurs have more power at their disposal, a fact known at least since Hobbes and Smith ([1976] 1776, p. 48). At the same time, Veblen emphatically stresses ([1964] 1923, pp. 236-237) that managers are able to decrease the rate of employment and to create unemployment by curtailing production.

A weak point in his analysis, appears to be his excessive discounting of the benefits of goodwill for the general welfare. In other words, he minimizes the effects of some elements of goodwill such as innovations in the production process or the provision of new or better goods, and the contribution of this to the welfare of the community. He also too heavily discounts the possibility that managers, by increasing the goodwill of the firm without widening the scope of their authority, may indirectly increase the productivity of the economy and the utility of consumers derived from the consumption of better or newer goods.

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