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SUMMARY

Reducing Market and Appropriation Uncertainty: The Twin Organizational Tasks of Entrepreneurship

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One of the reasons entrepreneurs are motivated to action is their assessment of the potential profit associated with a particular opportunity to recombine resources from the factor market into a product (or service) that will be demanded in the product market. Entrepreneurial firm survival often depends on the creation and appropriation of this profit. However, this profit is uncertain ex ante as it depends on the ex post difference between the costs that must be paid for the factors of production and the prices that will be realized for the finished product. This paper explores the relationship between uncertainty and the creation and appropriation of profit by entrepreneurial firms.

There are two distinct types of uncertainty the entrepreneurial firm must reduce in the process of creating and appropriating profit. First, it must reduce market uncertainty. That is, it must determine if the factors of production the opportunity requires can be attained in the factor market for less than the price their recombination is worth in the product market. The firm reduces market uncertainty by completing transactions for factors in the factor market and by completing transactions for its product in the product market. This very act of reducing market uncertainty, however, results in competition as factor suppliers, product customers, and product market competitors all seek to appropriate their 'share' of this new source of profit. In this scenario, the entrepreneurial firm may successfully reduce the market uncertainty, but may not appropriate all of the associated profit.

To prevent others from appropriating much of the profit, the entrepreneurial firm must reduce the second type of uncertainty, appropriation uncertainty. Reducing appropriation uncertainty can be costly as it often requires the firm to forecast which suppliers, customers, and competitors threaten to appropriate the most profit, to determine the transaction governance mechanisms that will most efficiently prevent them from appropriating the profit, and then to implement those governance mechanisms it believes will best protect its appropriation ability. However, if the firm reduces appropriation uncertainty in this way before reducing the market uncertainty, it risks wasting resources on unnecessarily costly governance mechanisms.

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