

# THE CONCEPT OF ENTREPRENEURSHIP: A COMPARATIVE ANALYSIS BETWEEN THE NEOCLASSICAL SCHOOL AND THE AUSTRIAN SCHOOL OF ECONOMICS

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**Abstract:** *Entrepreneurship holds a central yet uneven role in economic theory. This paper compares neoclassical and Austrian views of entrepreneurship. Neoclassical theory emphasises equilibrium, rationality, and perfect information. It largely marginalises the entrepreneur as an analytical category. Profit is seen as a temporary deviation or reward for risk, not discovery. The Austrian school places the entrepreneur at the core of market economies. It views entrepreneurship as a form of discovery amid uncertainty and dispersed knowledge. Entrepreneurs drive coordination, innovation, and market adjustment. The comparison reveals static vs. dynamic understandings of markets, and integrating both perspectives may enrich theory despite key differences.*

**Keywords:** *entrepreneurship, neoclassical school, Austrian school of economics*

## 1. Introduction

Entrepreneurship has long been regarded as a driving force behind economic progress, innovation, and structural transformation. However, economic theory has not always placed the entrepreneur at the centre of analysis. In fact, the role of the entrepreneur in a market economy differs significantly across schools of thought. While the Austrian school of economics places the entrepreneur at the heart of the market process, the neoclassical school has treated the entrepreneurial function as marginal or even absent from formal economic models. This difference in perspective raises fundamental questions about the nature of the free market, innovation, uncertainty, and economic coordination.

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The purpose of this paper is to provide a comparative analysis of how the neoclassical and Austrian schools conceptualise entrepreneurship. These two schools of economic thought present contrasting epistemological and methodological approaches. The neoclassical school emphasises equilibrium, optimisation, and formal modelling, while the Austrian school highlights dynamic processes, subjective knowledge, and the entrepreneurial discovery of new opportunities.

The research questions addressed by this article are as follows:  
a) How does each of the two schools of thought define and interpret the role of the entrepreneur in the market economy?

b) What assumptions regarding knowledge, uncertainty, and market coordination underlie the theoretical frameworks they formulate?

c) What are the implications of these views for understanding entrepreneurial behaviour and innovation in the real world?

The paper is organised as follows: the next section describes the methodological approach, and then entrepreneurship is presented from the two perspectives: neoclassical and Austrian (sections three and four). The comparative analysis represents the sixth section, followed by discussion and concluding remarks.

## **2. Methodology**

This study employs a comparative theoretical analysis, a method commonly used in the history of economic thought. The aim is not to empirically test hypotheses, but to assess conceptual differences and their implications for the explanatory power and internal logic of economic theories.

### **2.1. Criteria for comparison**

The comparison between the two schools of economic thought is carried out using the following five criteria:

1. Assumptions regarding human behaviour
2. The way information and uncertainty are handled
3. Role of innovation in the market process
4. Mechanisms of market coordination
5. Source and nature of entrepreneurial profit

### **2.2. Sources**

The analysis draws on the fundamental works of neoclassical and Austrian economists, including Léon Walras, Alfred Marshall, Frank Knight, Carl Menger, Ludwig von Mises, Israel Kirzner, and Joseph Schumpeter. As secondary sources, this paper used studies of economic methodology and entrepreneurship.

### 3. Entrepreneurship in neoclassical economics

Neoclassical economics, appearing by the end of the nineteenth century, is characterised by the formalisation of economic behaviour through mathematical modelling, a focus on equilibrium, and the assumption of rational, utility-maximising consumers and profit-maximising firms. Within this framework, the entrepreneur is not a central agent.

The neoclassical view considers entrepreneurship a factor of production. When neoclassical theory does include the entrepreneurs, it often treats them as a standard input similar to labour or capital. This fails to explain why certain individuals identify and exploit profit opportunities that others do not, effectively stripping the role of its creative and innovative essence

Founders of the neoclassical thought (Léon Walras, William Stanley Jevons, and Alfred Marshall) were primarily concerned with price formation, marginal utility, and market equilibrium. In their models, economic agents are idealised as *homo economicus*, acting with perfect rationality and complete information.

General equilibrium theory, founded by Walras (1874), assumes all markets are in a state of balance, with no unexploited opportunities. Under such conditions, the entrepreneurial action (which involves disequilibrium) has no analytical space. Prices adjust automatically, not through intentional discovery by market participants.

One of the notable neoclassical contributions is Frank H. Knight's (1921) distinction between risk (measurable probability) and uncertainty (immeasurable). For Knight, the entrepreneur earns profit as compensation for bearing uncertainty, and the entrepreneurial function is essentially about assuming responsibility for unpredictable outcomes. Nevertheless, Knight's entrepreneur remains conceptually passive – he is a manager of uncertainty rather than a discoverer of opportunities.

In the neoclassical models, innovation is often exogenous, introduced from outside the economic system as a shock. This is the reason why entrepreneurs do not operate within the model structure.

Several criticisms can be directed at neoclassical thinking:

- Overemphasis on equilibrium and limited attention to real-world market dynamics
- Absence of uncertainty-driven behaviour
- Lack of a mechanism for opportunity discovery
- Entrepreneurial profit is treated as an imperfection rather than a natural outcome of the market process.

In his seminal paper "Entrepreneurship in Economic Theory", William Baumol (1968) famously stated that "the theoretical firm is entrepreneurless" and compared the exclusion to a performance of *Hamlet* where the "Prince of Denmark has been expunged". He argued that while the entrepreneur is the "apex of the hierarchy", contemporary neoclassical theory has read them out of the model.

In a more recent paper (Giménez Roche, 2017), the author argues that, by assuming perfect rationality and complete information, neoclassical models leave the emergence and exploitation of profit opportunities unexplained.

#### 4. Entrepreneurship in the Austrian school of economics

The Austrian school approaches economics from a radically different epistemological view. It considers the economy as a dynamic and evolutionary process shaped by subjective knowledge, uncertainty, and entrepreneurial action.

Founded by Carl Menger, the Austrian school emphasises methodological individualism and subjectivism. And the role of time in the economic processes. The representatives of the later generations of Austrian thinkers (Ludwig von Mises, Friedrich von Hayek, and Israel Kirzner) further developed this dynamic perspective.

Eugen von Böhm-Bawerk (1851-1914), another significant Austrian economist and the successor of Carl Menger, did not theorise entrepreneurship as a distinct economic function. However, he contributed indirectly to the concept of entrepreneurship through his theory of capital and interest. Böhm-Bawerk's main works relevant to entrepreneurship are *Capital and Interest* (1884–1889) and *The Positive Theory of Capital* (1889).

Unlike the neoclassical tradition, Austrian economics sees entrepreneurship as fundamental. According to Mises (1949), every action is entrepreneurial because individuals constantly anticipate uncertain outcomes.

Israel Kirzner, a key figure in the Austrian School of Economics, discusses entrepreneurship extensively, especially in the context of market processes and discovery. His seminal work on the topic is *Competition and Entrepreneurship* (Kirzner, 1973). Kirzner's entrepreneur is characterised by alertness and discovery. The entrepreneurial alertness is the ability to notice previously unseen opportunities. Entrepreneurship is linked to market discovery, not to innovation, and profit represents a reward for correcting discoordination; so, the entrepreneur is a stimulator of market equilibration.

Although not entirely Austrian, Joseph Schumpeter's works (1934, 1939) align partially with Austrian thinking. His entrepreneur is an innovator – by introducing new products, methods, and organisational forms, and by disrupting equilibrium through “creative destruction”. Schumpeter's thought differs from that of Kirzner – innovation, not discovery, drives profit.

F. A. Hayek made an important, albeit *indirect and foundational*, contribution to entrepreneurship theory, even though he did not develop a formal theory of entrepreneurship in the same manner as Schumpeter or Kirzner. His contribution lies mainly in his conceptualisation of knowledge, markets, and competition, which later became central to modern entrepreneurship research. Hayek argued that knowledge in society is dispersed, local, and often tacit. No central planner can ever possess this

knowledge fully. This makes the entrepreneur essential as the actor who notices local conditions, uses context-specific knowledge, and acts under uncertainty.

According to Baumol (2003), all of economics recognises the importance of entrepreneurship, but until the work of the Austrians, little was done about it. Neoclassical economics could not deal with it in its models, because formal optimisation is largely irrelevant and because the entrepreneur's innovation is, by definition, purely heterogeneous. The Austrians, with their flexibility of method, were able to break through, following Schumpeter's great contribution.

The Austrian view considers markets as processes, not states, entrepreneurs as coordinators of plans across time, and genuine uncertainty as central to all market phenomena.

## 5. Comparative analysis

The table below summarises the key differences between the neoclassical school and Austrian economics.

The criteria for comparison were presented in the Methodology section.

Dimension	Neoclassical school	Austrian school
Human behaviour	Rational optimization, stable preferences	Subjective interpretation, heterogeneous expectations
Information	Perfect or near perfect	Imperfect, dispersed, tacit
Uncertainty	Rarely central, risk measurable	Fundamental, pervasive; source of entrepreneurship
Innovation	Exogenous	Endogenous, integral to entrepreneurial activity
Market process	Static equilibrium	Dynamic, evolutionary disequilibrium
Entrepreneur's role	Marginal, often omitted	Central agent of coordination and discovery
Profit	Temporary deviation from equilibrium	Reward for discovery, innovation, and uncertainty-bearing

The most profound divergence between the two schools of economic thought concerns the nature of markets: neoclassical markets gravitate towards equilibrium, while, in the Austrian vision, markets are in continuous flux due to entrepreneurial action. Austrians argue that without entrepreneurs, markets could not function, whereas neoclassical models function well without them.

At the same time, some areas of limited convergence can be identified: both schools recognise profit as a deviation from normal outcomes, but disagree on its cause: risk-bearing versus discovery/innovation.

Some authors have made comparisons between the two schools of economic thought. A notable contribution is made by Huerta de Soto (2008). He explores the essential difference between the Austrians and the neoclassicals. A point of comparison is the protagonist of social processes, who is, according to the Austrian paradigm, the creative entrepreneur, and Homo economicus for the neoclassical economists. The same author uses as a point of comparison the “possibility that actors may err *a priori*, and the nature of entrepreneurial profit”. According to the Austrian view, actors may conceivably commit pure entrepreneurial errors that they could have avoided had they shown greater entrepreneurial alertness to identify profit opportunities. In the neoclassical vision, regrettable errors are not regarded as such, since all past decisions are rationalised in terms of costs and benefits; entrepreneurial profits are viewed as rent on a factor of production.

## 6. Discussion

The analysis reveals that the two economic schools supply contrasting yet complementary insights. The strengths of the neoclassical perspective consist of: it provides analytical clarity through formal models, it is useful for static efficiency analysis, and it highlights long-run equilibrium tendencies. Its weakness is represented by the underestimation of dynamic processes and real-world decision-making.

The strengths of the Austrian perspective can be described as follows: it offers a rich account of uncertainty and knowledge, a realistic portrayal of entrepreneurial action, and focuses on processes rather than statistical outcomes. However, its lack of formal modelling may limit the predictive precision.

From the above comparison, the relevance for modern entrepreneurship research can be derived. Modern entrepreneurship studies increasingly align with Austrian thinking concerning opportunity recognition, innovation ecosystems, and market process theory. Neoclassical theory remains useful for modelling incentives and market structures.

While epistemological differences exist between the two perspectives, some hybrid theories have emerged:

- Incorporating uncertainty into neoclassical models (Knight, 1921)
- Treating innovation endogenously (endogenous growth theory). Paul Romer (1986; 1990) is the central figure in endogenous growth theory. His 1986 and 1990 models emphasised the role of knowledge, innovation, human capital, and R&D as drivers of long-run economic growth generated *within* the economy rather than by external forces.
- Behavioural economics acknowledges bounded rationality. Herbert A. Simon (1947) introduced *bounded rationality*, arguing that individuals satisfice rather than optimise. Daniel Kahneman pioneered the psychological foundations of decision-making (2011) and co-developed the *prospect theory together with* Amos Tversky (1979).

## 7. Conclusion

This paper demonstrates that the neoclassical and Austrian schools conceptualise entrepreneurship in fundamentally different ways. Neoclassical economics, with its emphasis on equilibrium and optimisation, provides limited space for the entrepreneur as an active agent in the market economy. In contrast, the Austrian school of economics positions the entrepreneur at the heart of economic life, attributing market coordination, discovery, innovation, and adjustment processes to entrepreneurial action.

The comparison reveals that the Austrian theory supplies a richer and more dynamic account of entrepreneurship, while the neoclassical school excels in analytical precision but lacks explanatory power for real-world entrepreneurial behaviour. There is a significant field for potential future research for exploring how to integrate insights from both traditions, especially in areas such as innovation policy, opportunity recognition, and the micro-foundations of market dynamics.

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