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Entrepreneurship and Industrial Organization: A Review and Research Agenda

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ABSTRACT

Industrial organization and entrepreneurship can be closely associated subjects, as both require an understanding of the structure and behavior of firms within an industry. This paper aims to review the literature connecting industrial organization and entrepreneurship to develop a better understanding and propose a research agenda. It provides insights into the emergence, development, and conceptual synthesis of industrial organization and entrepreneurship-related issues for future research. The findings reveal that entrepreneurship can be correlated with industrial organization primarily through entry, innovation, and competition. This connection seeks to understand how new firms emerge and grow within existing industries and how incumbents can adapt and compete with new entrants. Entrepreneurship also plays a crucial role in facilitating market entry which can also foster increased innovation and competition. The recognition that entrepreneurship can stimulate entry, innovation, and competition underscores its critical role in shaping market dynamics. This highlights the need for interdisciplinary research, where scholars and policymakers can collaborate to gain a more holistic understanding of market dynamics and promote economic growth.

Keywords: Competition, Entrepreneurship, Entry, Industrial Organization, Innovation

INTRODUCTION

Industrial organization (IO) is a field of economics that studies the behavior of firms and markets in the context of imperfect competition (Tremblay & Tremblay, 2012). It is concerned with understanding how firms make strategic decisions about pricing, advertising, product differentiation, and other factors to gain a competitive edge and maximize profits. Industrial organization and entrepreneurship are closely related fields, as both involve understanding the structure and behavior of firms within an industry.

Entrepreneurship focuses on the creation and growth of new businesses, while industrial organization studies the behavior and performance of existing firms in a given industry (Baumol, 1993). Both fields examine the strategies and tactics used by firms to compete with one another, as well as the impact of market structure on firm behavior and performance. Entrepreneurship can be seen as a subset of industrial organization, as new firms often enter industries and disrupt the status quo. Entrepreneurial firms may use innovative business models, technologies, or marketing strategies to gain a foothold in the market and challenge established firms (Gartner, 1990).

Industrial organization can also inform entrepreneurship by providing insights into the competitive dynamics of an industry, identifying opportunities for new firms to enter, and highlighting potential barriers to entry (Kirzner, 1997). Entrepreneurial firms can use this knowledge to craft their strategies and navigate the competitive landscape. It can be seen that industrial organization and entrepreneurship are interrelated because they both deal with the functioning of markets, the behavior of firms, and the strategies used to compete and succeed in various industries. Entrepreneurs can benefit from insights derived from industrial organization theory when making strategic decisions and navigating competitive landscapes.

Hence, the connection between entrepreneurship and industrial organization is important for understanding how new businesses emerge and grow within existing industries, and how existing firms can adapt and compete in response to new entrants. This seminar paper aims to review the literature connecting industrial organization and entrepreneurship in order to develop a better understanding and propose a research agenda.

LITERATURE REVIEW

Industrial organization and entrepreneurship are fascinating areas of study that sheds light on crucial aspects of market dynamics, including entry, innovation, and competition. This literature review will delve into these key themes to provide an understanding regarding the intricate relationships between industrial organization and entrepreneurship. It is found that the concept of entry has a pivotal part in understanding the dynamics of industrial organization. Entrepreneurial entry into markets is a fundamental mechanism that restores equilibrium by mitigating the concentration of power among established players (Gartner, 1990). A vibrant ecosystem of entrepreneurs engaging in market entry contributes to competition, fosters innovation, and disrupts established industrial structures (Baumol, 1993). Research in this domain has elucidated various facets of entry. Notably, scholars have examined the entry barriers that entrepreneurs encounter in different industries. High entry barriers can limit entrepreneurial activity, particularly in concentrated markets, where incumbents often enjoy substantial advantages in terms of resources, scale, and market share (Audretsch, Link & Lehmann, 2020). Empirical studies have shown that policies aimed at reducing entry barriers, such as regulatory reforms and access to financing, can stimulate entrepreneurship and promote competition (Aghion, Blundell, Griffith, Howitt, & Prantl,

2009). Furthermore, the literature highlights the importance of entrepreneurial entry in shaping industrial evolution. It has been widely recognized that entrepreneurial firms have the potential to disrupt existing industries by introducing innovative products, services, and business models. Schumpeterian "creative destruction" underscores the transformative role of entrepreneurs in driving economic progress by replacing outdated or inefficient incumbents (Schumpeter, 1942).

Meanwhile, innovation is a cornerstone of the relationship between industrial organization and entrepreneurship. Industrial organization and innovation are closely related because innovation is a key driver of competition and market structure, which are central concerns of industrial organization (Marshall & Parra, 2019). Entrepreneurs are often at the forefront of technological and business model innovation, contributing to the dynamism of industries. Their ability to identify and exploit new opportunities fuels innovation-driven growth. Numerous studies have explored the link between entrepreneurship and innovation. For example, entrepreneurs may serve as catalysts for innovation, bridging the gap between academic research and commercialization (Audretsch & Link, 2018). Startups and entrepreneurial ventures are known for their propensity to engage in risky, exploratory innovation, which can disrupt established industries or create entirely new ones (Eisenhardt & Martin, 2000). Moreover, the advent of the digital age has amplified the impact of entrepreneurship on innovation. Technology startups in particular have harnessed digital tools and platforms to accelerate innovation and rapidly penetrate markets. The "startup ecosystem" has emerged as a vibrant environment where entrepreneurs, investors, and accelerators collaborate to foster innovation and entrepreneurship (Isenberg, 2010).

Moreover, competition is a central theme in both industrial organization and entrepreneurship. Entrepreneurship has the potential to increase the intensity of competition within markets. By entering markets, introducing new products, and engaging in innovative activities, entrepreneurs challenge the market power of incumbents. Audretsch, Baumol, and Burke (2001) emphasize that entrepreneurship enhances competition in markets, an aspect that is sometimes overlooked in antitrust and competition policy discussions. Policymakers and regulators must recognize that entrepreneurial activities can contribute to more competitive and consumer-friendly markets. Moreover, entrepreneurial strategies are often distinct in their approach to competition. Entrepreneurs may employ disruptive strategies, niche-focused approaches, or rapid innovation to gain a competitive edge. Research in this area has delved into the strategic choices made by entrepreneurs and their impact on industry dynamics (Eisenhardt & Schoonhoven, 1990).

Therefore, it can be seen that the literature on industrial organization and entrepreneurship underscores the intricate interplay between these two domains, with entry, innovation, and competition serving as critical points of analysis. Entrepreneurship is a dynamic force that can reshape industrial landscapes, disrupt established firms, and foster innovation-driven growth.

RESEARCH METHOD

This study is grounded in a comprehensive examination of literature pertaining to industrial organization and entrepreneurship. The literature review adheres to the guidelines outlined by Snyder (2019). The primary aim was to propose a theoretical framework that establishes a connection linking industrial organization and entrepreneurship. In accordance with the guidelines, the relevant literature was identified and summarized to construct a meaningful comprehension. The methodology employed in this study aligns with the integrative literature review approach, which seeks to

evaluate and synthesize literature pertaining to a research topic, allowing for the emergence of new theoretical viewpoint (Torraco, 2005). Literature reviews that are integrative can typically be employed in the context of well-established or emerging research areas. According to Sachez-Rebull in Ardani, Rahyuda, Giantari, and Sukaatmadja (2019), literature review helps to carefully synthesize the literature that has already been published and enables researchers to replicate or redo the study on the same or other themes. In established fields, the purpose of employing an integrative review approach is to develop a comprehensive summary of the current body of knowledge, subject it to critical evaluation, possibly rethink its conceptual framework, and actively contribute to the growth of the subject's theoretical underpinnings as it progresses. When it comes to the data analysis phase of an integrative or critical review, there is not a specific set of rules to adhere to, as noted by Whittemore and Knafl in 2005. However, despite the absence of a rigid template, the overarching goal of data analysis in an integrative review is to conduct a thorough evaluation and exploration of the literature, along with the fundamental concepts and connections within the field. The aim of employing the integrative review method is to advance knowledge and foster the development of theoretical frameworks, rather than merely presenting an overview or description of a research area. In simpler terms, it should go beyond being merely descriptive or historical and ideally lead to the generation of a novel conceptual framework or theory.

RESULTS

The literature findings indicate that entry plays a key role in industrial organization because it serves as a mechanism to restore the market to a state of zero-profit equilibrium (Audretsch, Link & Lehmann, 2020). This concept has its roots in a pivotal point in the debate between Joe Bain and George Stigler, which highlighted the extent to which established market incumbents can exert influence when other companies attempt to sell their products to the same customer base (Rosado-Cubero, 2015). Put simply, it assesses the response of well-established companies when a new rival enters a common market. While collaborating with other companies to eliminate new competitors is one option, it comes at a higher long-term cost compared to the cost of competing (Rosado-Cubero, 2015).

Stigler (1946) implemented a new function which allows companies to gain monopoly within their industry, primarily through new combinations of inputs or because they are industry pioneers. This means wiping out tendencies of entry that discourage new competitors from entering the industry under the guise of normal corporate behaviour. Meanwhile, Bain (1956) developed the theory of limit price to explain the behaviour of firms within an industry in terms of oligopoly theory: “If they are subject to an effective threat of entry, so that new firms would enter at the price OP, but can exclude entry at a lower “limit” price, they may do this if the long-run profits promised to them by the later policy is greater” (Bain, 1956, p. 286).

When a company finds a competitor, one of the most common sets of action is to lower its price in the market. However, lower prices mean lower profits for new entrants and this may cause them to rethink their decisions. This could also mean that the profit must survive in the long term for the incumbents not to face any problem. Bain (1956) wrote that: “A barrier to entry of some height instead typically permits established firms to raise price above the minimum cost level without inducting an automatic correction through entry and potentially to raise it high enough to permit them to operate profitably with unit costs which are not the lowest attainable for the going industry output” (Bain, 1956, p. 441).

The literature in industrial organization has highlighted the importance of Entry Barriers as a critical mechanism for achieving a market state with zero profits in long-term equilibrium (Bain, 1956). These barriers encompass factors such as economies of scale, cost advantages, product distinctiveness, and capital requirements (Bain, 1956). In this paradigm, which is rooted in a perfectly competitive microeconomic model, Entry Barriers serve as a vital link connecting industrial structure to performance (McWilliams & Smart, 1995). This framework assumes a static environment where firms operate under equilibrium conditions.

Expanding on the concept of entry, Porter (1980) emphasizes that a firm's power is influenced by factors affecting market entry, including the presence of entry barriers, capital needs, distribution access, learning curve advantages, and government policies (Evans & Neu, 2008). The level of threat depends on the absence or abundance of entry barriers; fewer barriers make it easier for new businesses to enter and compete, while numerous and enduring barriers allow existing firms to maintain their market position and benefit from it.

Without entry barriers, increased production by market participants erodes positive economic returns and restores long-term market equilibrium (Sutton, 2007). The idea of market entry does not specify the identity or type of companies constituting this entry. Newcomers may consist of established companies venturing into fresh product or geographic markets or entrepreneurial startups entering the industry from scratch. It is important to note that although entrepreneurial startups are considered newcomers in the industry, not all newcomers are necessarily entrepreneurial startups. Research in industrial organization literature has examined which forms of organization play a more prominent role in entry, with some cases highlighting new entrants as key organizers of an industry, while in others, existing incumbents dominate (Gort & Klepper, 1982).

In addition to market entry, another significant overlap between industrial organization and entrepreneurship lies in the sphere of innovation (Audretsch & Link, 2018; Link, 2016; Link, Morris, & van Hasselt, 2020). Schumpeter (1942) argued that entrepreneurs are individuals responsible for orchestrating the development of novel combinations of resources and identifying and seizing economic opportunities. It was not until the 1980s, driven by a revolution in growth theory, that the role of entrepreneurship in economic advancement gained prominence (Low & MacMillan, 1988). Within the industrial organization literature, both Schumpeter (1942) and Chandler (1990) proposed that the size of a firm stimulates innovation (Scherer & Ross, 1990). The knowledge-producing functional model of innovation connects inputs such as human capital and research and development (R&D) to innovative outcomes (Griliches, 1979).

Typically, large corporations are believed to have an innovation advantage due to economies of scale, as they possess more resources, human capital, and advanced management capabilities (Penrose, 1955). Nonetheless, it is important to note that in the entrepreneurship literature, small new firms have been found to be highly innovative despite limited investments in R&D and human capital. The knowledge spill-over theory of entrepreneurship proposes that innovation in new and small firms occurs as they apply knowledge generated in one context, resulting in innovation through the establishment of a new firm (Audretsch, 1995).

Additionally, innovation plays a pivotal role in a company's growth strategy, facilitating differentiation, market share expansion, cost reduction, efficiency enhancement, and overall competitiveness. A third significant intersection between entrepreneurship and industrial organization lies in the realm of competition. The concept of competition as a mechanism to counter the exploitation of market power has been acknowledged for quite

some time, dating back to Clark and Clark in 1912. However, it was not until later, particularly with the works of Joe Bain and Paolo Sylos-Labini, that economists began to reevaluate this concept. These investigations, drawing from imperfect competition, optimal control, and dynamic game theories, evolved into increasingly sophisticated models of how incumbent competitors respond to the threat of new competition (Gilbert, 1989). Moreover, entrepreneurship is frequently associated with heightened market competition and diversity through innovative activities.

Entrepreneurship is seen as a catalyst that elevates competition levels in the market, potentially making entrepreneurship policies influential in antitrust and competition regulation (Audretsch, Baumol, & Burke, 2001). Traditional competition and antitrust policies were rooted in static models and static analyses of industrial organization (Audretsch, Baumol, & Burke, 2001). Nevertheless, contemporary developments in the industrial organization literature have transcended traditional static models and concerns primarily about price competition. The field now incorporates dynamic approaches that consider the evolution of industries in a changing context. These dynamic approaches take into account performance in relation to variations in available consumer products, firm competencies, rankings, growth, entry, and exit. The evolution of industrial organization literature also encompasses models of industry and market evolution (Audretsch, Baumol, & Burke, 2001).

It can be seen that the relationship between entrepreneurship and industrial organization involves understanding how new businesses emerge and expand within existing sectors and how established companies can adjust and compete against new contenders. Entrepreneurship also serves as a catalyst for entering markets. Entrepreneurs frequently introduce novel products and services that were previously unavailable, creating fresh opportunities for other entrepreneurs to enter the market and engage in competition. This influx of new participants can also drive more innovation and rivalry. Concerning innovation, entrepreneurship frequently entails the development of inventive and value-added products, services, or business models that fulfill market demands. Innovation, competition, and market entry are all closely tied to the field of industrial organization. Each of these elements significantly influences the structure and behavior of firms within an industry, and comprehending their interplay aids in analyzing market dynamics over time.

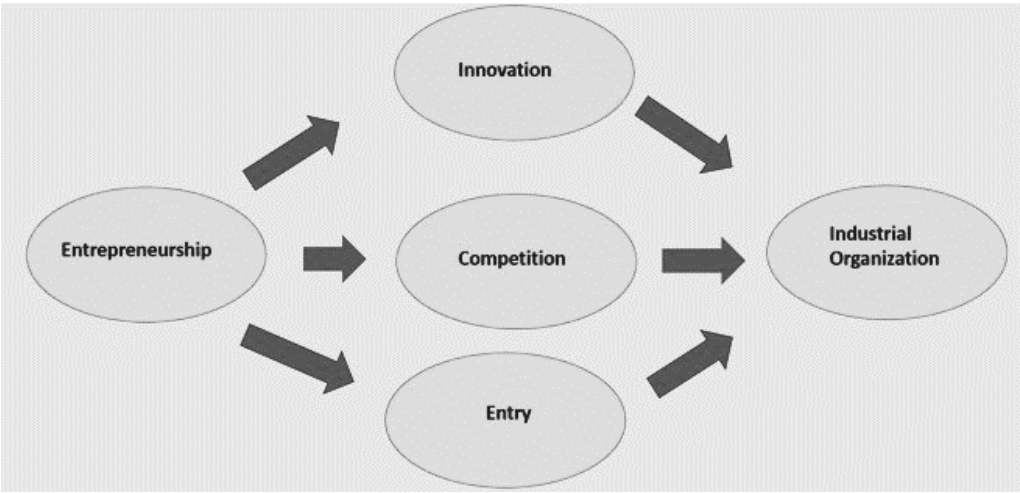
The theoretical foundation of market entry can be traced back to Bain's work in 1956. In the realm of industrial organization, barriers to entry have been seen as the primary means of achieving a level of production that results in zero profits in the long-term equilibrium (Bain, 1956). These barriers to entry encompass factors such as economies of scale, absolute cost advantages, product differentiation, and capital requirements (Bain, 1956). Bain, an advocate of the structuralist school, contends that the effectiveness of potential competition hinges on the determinants of entry conditions, including economies of scale, technological advantages, and absolute cost advantages (Kemp et al., 2003). Although barriers to entry are structural in nature, the conditions of entry are often influenced by the behavior of established firms. In contrast, Stigler (1946) representing the Chicago school, argues that market concentration reflects the differing efficiencies of incumbent firms, with barriers to entry primarily arising from restrictions on market conduct imposed by the government (Kemp et al., 2003). To delve into the mechanism of barriers to entry, it is essential to differentiate between two types of entry: small-scale and large-scale entry.

In the case of small-scale entry, new entrants introduce relatively limited output to the market, which has little impact on market prices, while the cost advantage of existing incumbents remains significant (Blees et al., 2003). Conversely, the mechanism operates differently in the case of large-scale entry. In such instances, potential entrants recognize that large-scale entry reduces market prices (Kemp et al., 2003). Post-entry prices are expected to be lower than pre-entry prices because the market must absorb the additional capacity, and this is only achievable through price reductions (Blees et al., 2003).

DISCUSSION

There are three main dispositions in which entrepreneurship can be correlated with industrial organization, which are through entry, innovation, and competition. This can be seen in the figure below:

Figure 1. The Correlation Between Entrepreneurship and Industrial Organization: Innovation, Competition, and Entry



The connection between entrepreneurship and industrial organization is to perceive how new firms come up and grow within existing industries, and how incumbents can adapt and compete with new entrants. Entrepreneurship can also facilitate market entry. Entrepreneurs often introduce new products and services that were previously unavailable, opening up new opportunities for other entrepreneurs to enter and compete in the market. Entry can also lead to more innovation and competition. When it comes to innovation, entrepreneurship often involves creating innovative, value-added new products, services, or business models that meet market needs. Innovation, competition, and entry are all closely related to industrial organization. Each of these factors plays a crucial part in shaping the structure and behavior of firms within the industry, and understanding how they interact will help analyses market dynamics over time.

It can be seen that industrial organization and entrepreneurship are strongly associated subject, as both require understanding the structure and behavior of firms within an industry. It is also largely associated with entry, innovation, and competition. Overall, this paper proposes research agenda as follows. Firstly, the recognition that entrepreneurship can stimulate entry, innovation, and competition underscores its critical role in shaping market dynamics. This highlights the need for interdisciplinary research, where scholars and policymakers can collaborate to gain a more holistic understanding of market dynamics and promote economic growth. Secondly, the findings reveal that entrepreneurship can be correlated with industrial organization primarily through entry, innovation, and competition. This highlights the need to understand how new firms emerge and grow within existing industries and how incumbents can adapt and compete with new entrants. Lastly, entrepreneurship also plays a crucial role in facilitating market entry, which may foster further research in increased innovation and competition.

This research agenda emphasizes the significance of cross-disciplinary research, where academics and policymakers can work together to achieve a more holistic comprehension of market trends and stimulate economic advancement. Economic growth is connected to the expansion of goods and services production within the economic activities of individuals (Bhegawati & Sukarnasih, 2023).

CONCLUSION

Overall, it can be seen that industrial organization and entrepreneurship are strongly associated subject, as both require understanding the structure and behavior of firms within an industry. It is also largely associated with entry, innovation, and competition. The results indicate that entrepreneurship and industrial organization can be interconnected, especially in terms of entry, innovation, and competition. This connection aims to explore how new businesses come into existence and thrive in established industries, and how established players can adjust and compete against newcomers. Additionally, entrepreneurship is instrumental in enabling new players to enter the market, which, in turn, encourages greater innovation and competition. Recognizing that entrepreneurship can trigger entry, innovation, and competition underscores its pivotal role in shaping how markets operate. This underscores the importance of interdisciplinary research, where scholars and policymakers can collaborate to gain a more comprehensive understanding of market dynamics and promote economic growth.

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DECLARATION OF CONFLICTING INTERESTS
I do not have any current or potential interests or conflicts to disclose in connection with this research. When I refer to a conflict of interest, I mean anything that might reasonably be seen as influencing the objectivity of this research or as revealing a professional or personal stake in the results of this research.

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