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Entrepreneurs as intermediaries

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ABSTRACT

This paper sketches the contours of a theory of entrepreneurship focusing on the nature of entrepreneurship as intermediation under information asymmetries. While entrepreneurship, strategy, and finance researchers have studied the relationship between entrepreneurs and intermediaries, they tend to treat intermediaries, such as venture capitalists, as a separate organizational form that is parallel with (start-up) entrepreneurs. In this paper, we consider entrepreneurs as intermediaries who discover, create, and exploit entrepreneurial opportunities by bearing uncertainties stemming from intermediation between potential buyers and sellers under information asymmetries. Specifically, we focus on two key questions in entrepreneurship research: (1) Why do entrepreneurs arise and exist at all? (2) Why do some entrepreneurs perform better than others in creating entrepreneurial opportunities and ultimately creating wealth? Our discussion culminates in a new research agenda with four testable propositions.

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1. Introduction

"Both history of science and creativity research have shown that reformulating the questions we ask can lead to breakthroughs more often than trying harder to search for more rigorous answers" (Sarasvathy, 2004: 707). In search of such a more creative spirit, we in this paper advance the argument that the nature of entrepreneurship can be viewed from a new angle—intermediation. Intermediation is an entrepreneurial role critical in the discovery and creation of entrepreneurial opportunities. In the past literature, entrepreneurship has traditionally been defined as "the discovery, evaluation, and exploitation of future goods and services" (Eckhardt & Shane, 2003). In light of this definition, both opportunity discovery theory and opportunity creation theory have addressed two key questions centered on the nature of entrepreneurship (Amit, Glosten, & Muller, 1993; Foss, Klein, Kor, & Mahoney, 2008): (1) Why do entrepreneurs arise and exist? (2) Why do some entrepreneurs perform better than others in creating opportunities, adding value, and creating wealth?

While there are many different ways of conceptualizing entrepreneurial firms, past research tends to look at new start-ups as entrepreneurial firms (Aldrich, 1999; Katz & Gartner, 1988). However, not all new firms discover, exploit, and create new goods or services that can add value to the economy (Schumpeter, 1934). In that sense, we argue that entrepreneurship research can use a different definition of *entrepreneurs*—individuals and/or organizations that discover and create entrepreneurial opportunities in the value chain in an industry—rather than the traditional definition of "start-up" firms.

Our argument is based on classical insights of Austrian economics (Kirzner, 1973; Schumpeter, 1934; von Mises, 1949), which classifies five representative types of entrepreneurial opportunities as (1) creating a new product, (2) creating a new method of production, (3) discovering a new market, (4) discovering or creating a new production factor, and (5) creating a new organizational form or industry (Schumpeter, 1934). In order for entrepreneurs to discover or create these entrepreneurial opportunities, they have to bear uncertainties stemming from their opportunity discovery/creation efforts (Klein, 1999). A major way that entrepreneurs bear uncertainties is intermediating between potential buyers and sellers in the value chain, since buyers and sellers may neither be willing to bear uncertainties stemming from opportunities nor have the abilities to discover or create opportunities (Kirzner, 1997; Klein, 1999; von Mises, 1949).

In the past literature, opportunity discovery theory posits that entrepreneurs can add value by exploiting exogenously given opportunities in pre-existing markets (Kirzner, 1997; Shane & Venkatraman, 2000). Opportunity creation theory claims that entrepreneurs add value by endogenously creating new market opportunities (Aldrich, 1999; Baker & Nelson, 2005; Sarasvathy, 2001). Despite the significant progress in our understanding of discovering and creating entrepreneurial opportunities, we still have limited knowledge on how entrepreneurs discover or create

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opportunities by taking advantage of information asymmetries in markets (Fiet, 2007). Thus, the processes that entrepreneurs discover and create opportunities have remained as a gap to be filled in entrepreneurship research (Klein, 2008).

In response, this paper extends current theories by arguing that the nature of entrepreneurship can be viewed as intermediation. We accomplish this by focusing on three questions extended from key questions of entrepreneurship: (1) How do entrepreneurs add value in the value chain via intermediation? (2) Under what conditions would entrepreneurs be better able to exploit pre-existing opportunities via intermediation? (3) Under what conditions would entrepreneurs be better able to create new opportunities via intermediation?

Why is the "intermediation" perspective useful to push entrepreneurship research further? Three reasons emerge. First, it is because entrepreneurs, by definition, are individuals and/or organizations that add value in the process of enacting and exploiting entrepreneurial opportunities (Brandenburger & Stuart, 1996; Foss et al., 2008). Capturing economic value by discovering and creating opportunities always brings people who are willing and able to bear uncertainties to connect their potential buyers and sellers (Klein, 1999; von Mises, 1949). Second, some entrepreneurs choose to play intermediation roles because they believe they are better able to discover and create opportunities when there are information asymmetries between buyers and sellers in the value chain (Spulber, 2009). Third, compared to the traditional definition of entrepreneurship, the intermediation concept broadens the scope of entrepreneurs. We can reinterpret the role of intermediary entrepreneurs, such as venture capitalists, with this new perspective.

To be sure, entrepreneurship, strategy, and finance researchers are familiar with specialized intermediaries such as venture capitalists and financial service firms. However, researchers tend to focus on the relationship between intermediaries and (start-up) entrepreneurs, thus implicitly treating intermediaries as a separate organizational form that is parallel with (start-up) entrepreneurs (Lim & Cu, 2012). As a result, while the strategies and performance of venture capitalists have been explored to a certain extent, the bulk of entrepreneurship research has concentrated on the other side of this relationship—namely, "entrepreneurs" who, by default, are not intermediaries. This paper departs from the existing literature by arguing that it is beneficial to view intermediaries *as* entrepreneurs. In other words, venture capitalists themselves can be conceptualized—and should be studied—as entrepreneurs (Klein, 1999; Wasserman, 2002).

The objective of this paper goes substantially beyond merely labeling venture capitalists as entrepreneurs. We argue that, under information asymmetries, many entrepreneurs who attempt to discover and create entrepreneurial opportunities achieve their goals by intermediating between buyers and sellers in the value chain. We suggest that a more parsimonious and testable theory is to view entrepreneurs as intermediaries who discover and create entrepreneurial opportunities stemming from information asymmetries and market failures. In addition, we propose boundary conditions that entrepreneurs discover and create entrepreneurial opportunities through intermediation, drawing on two leading theories in the literature: transaction cost economics (TCE) and the resource-based view (RBV). TCE and RBV are relevant theoretical perspectives for our arguments because both assume entrepreneurs' act of uncertainty-bearing is a key driver in the entrepreneurial process.

2. What are intermediaries?

According to the economics of market microstructure, an intermediary is an economic player who "helps buyers and sellers meet and transact" (Spulber, 1999: 3). In general, intermediaries add value by "transporting, storing, repackaging, assembling, preparing for final use, and adding information and guarantees" (Spulber, 1996: 136). We extend this definition of intermediation in a broader sense. We define intermediaries as individuals and/or organizations that position themselves somewhere on the value chain and make efforts to discover or create entrepreneurial opportunities by bearing uncertainties that their potential buyers and sellers would be neither willing nor able to bear.

With this broader definition, intermediaries can add value by brokering between buyers and sellers under the condition of information asymmetries—in other words, making markets (Cantillon, 1959). For example, Amazon.com has created a new market space by utilizing the emergence of the Internet. Before Amazon emerged as an online commerce intermediary, other incumbents were already arbitraging information asymmetries between book buyers and sellers. What really happened is "re-intermediation." Basically Amazon, as a new intermediary, has emerged to displace some incumbents and created a new market space with a new set of distribution channels that reduced transaction costs between buyers and sellers (Anderson & Anderson, 2002).

In addition, "traditional" intermediaries are known to exist in sectors whereby information asymmetries between buyers and sellers of goods and services are strong (Akerlof, 1970), such as financial markets and international trade. In financial markets, borrowers typically have deeper knowledge about their capabilities than do lenders (Myers & Majluf, 1984). But due to moral hazard, borrowers cannot be expected to be entirely straightforward about their characteristics, since there are substantial rewards for exaggerating positive qualities. Financial intermediaries emerge as a solution to this problem, by signaling value to financial markets as a function of the size of the stake that intermediaries take in borrowers (Allen & Santomero, 1997; Campbell & Kracaw, 1980; Peng & Wang, 2002). As a result, "information asymmetries may be a primary reason that [financial] intermediaries exist" (Leland & Pyle, 1977: 383). Similarly, information asymmetries are pervasive in international trade, which is characterized by geographic and cultural separation between buyers and sellers (Peng, 1998). International trade intermediaries, such as export trading companies and export management firms, thus serve as a bridge connecting domestic producers and foreign buyers (Peng & Ilinitch, 1998). Specifically, trade intermediaries can conduct market research for prospective exporters, negotiate the deal on their behalf, and help enforce the contract (Ellis, 2003; Trabold, 2002).

Although financial and trade intermediation cases show excellent examples of value-adding mechanisms of traditional intermediaries, our entrepreneurship-as-intermediation perspective can be applied more broadly as long as the more general context of pervasive information asymmetries exists. We suggest that information asymmetries that require market-making intermediation would be more prevalent in industries that require complex sets of knowledge, such as architecture, consulting, and legal industries. In knowledge-intensive industries, it is likely that complex, tacit, and specialized knowledge would bring high levels of information asymmetries between knowledge sources and recipients (Graebner, Eisenhardt, & Roundy, 2010). Thus, intermediaries with deeper knowledge about the specialized transaction processes under information asymmetries may be able to exploit this knowledge, while intermediaries with more general knowledge about the generic transaction processes may be less able to do so (Fiet, 2007; Pinkham & Peng, 2013).

In sum, we define intermediation as any entrepreneurial roles in discovering or creating entrepreneurial opportunities by making markets between potential buyer and sellers in the value chain. We

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