Series editor's foreword

Ivan Pongracic's *Employees and Entrepreneurship* breaks new ground in the study of the organization of economic activities within the business firm from the perspective of the Austrian School of Economics. He emphasizes the role of spontaneous order within firms. Successful firms, he argues, use the decentralized decision-making structure to foster creative responses among employees. He argues decentralized firms are decentralized precisely for this reason: they give decision-making power to employees in order to extract creative action from them. This emphasis on cultivating creativity among employees inside the firm, rather than disciplining them by aligning incentives, is a unique contribution of Pongracic. He marshals this analytical framework to interpret the modern evolution of business practice over the last quarter-century, which has seen both delayering of firm structure and an emphasis on creative work in firms such as Google.

Since the mid-1980s several works in the Austrian tradition have addressed the theory of the firm. These studies tend to emphasize the importance of decentralized knowledge and the alignment of incentives within the firm to mobilize dispersed knowledge. A classic work in this tradition is Frederic Sautet's *An Entrepreneurial Theory of the Firm*, with its emphasis on the M-form organization and the Hayekian knowledge problem that business enterprises must confront and solve for the successful co-ordination of economic plans within the firm. Pongracic's work fits nicely into this modern literature. However, Pongracic's work is the first work in this literature to address in depth the radical decentralization and flattening of managerial structures that have been witnessed over the past quarter-century within capitalist economies.

The theory of the firm has an unusual history in the discipline of economics. Classical economists acknowledged the role that the entrepreneur played in a dynamic economy. But as the discipline of economics evolved in a technical direction in the twentieth century, the entrepreneurial element in economic life had to be purged. The reason for the purging was straightforward. Entrepreneurship is about creativity, novelty, and innovation – things that are not easily captured in deterministic models. As the model of perfect competition came to dominate the intellectual agenda in microeconomics, not only entrepreneurship but also management and strategy were

pushed aside. Instead, the theory of the firm that developed mid-century was a theory of production functions.

Ronald Coase had offered an alternative theory of the firm focusing on the transaction costs of market exchange, and emphasizing the rationale for organization of economic activities in the firm to minimize transaction costs. But Coase's theory of the firm never really gained wide acceptance until Armen Alchian and Harold Demsetz focused on the problems of team production, and Oliver Williamson engaged in an act of intellectual arbitrage by using Coasian ideas to make sense of Alfred Chandler's work on managerial capitalism. The focus of this literature was on the structure of the firm and managerial strategy. This literature mainly focused on the appropriate alignment of incentives within the firm.

Parallel to these developments, scholars such as Israel Kirzner worked tirelessly to reintroduce the entrepreneurial element of the market process into economic analysis. With respect to the firm, Kirzner tended to emphasize the selling costs associated with the delivery of products to consumers as well as the production costs. But Kirzner did not really discuss the internal structure of the firm and the managerial strategies adopted to realize profits. The Austrian literature on the firm really took off with Richard Langlois. Langlois reached backward to Edith Penrose, Fritz Machlup, and F.A. Hayek, and synthesized these works with the contemporary theory of the firm found in Alchian, Coase, and Williamson. The literature within the Austrian School that Langlois inspired includes works by Nicolai Foss, Peter Klein, Peter Lewin, and Frederic Sautet.

But this literature did not focus on the contemporary empirical trend of demanagement. In fact, Williamson in one of his classic works posed the Coasean question as 'markets' or 'hierarchy'. But in the years since he published *Markets and Hierarchies* (1975), firms have flattened their hierarchical structures without eliminating the unity of their business enterprises. Enter Pongracic. Here we start from the existing reality of the 'free agent nation' and the 'delaying' of the business enterprise. A rather stark example of this sort of new freedom in the organization of economic activities within the firm would be Google, where the work environment and structure of labor contracts are far more flexible and creative than could even be imagined in a traditional hierarchical firm.

Ivan Pongracic's *Employees and Entrepreneurship* is a welcome addition to the Austrian literature on the theory of the firm, and represents a significant step forward by demonstrating the relevance of the ideas of Mises, Hayek, Kirzner and Lachmann for the contemporary world of business and the entrepreneurial market process.

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