The “Character” of Profit and Loss:
Entrepreneurial Virtues

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Abstract: It is common to say that in the commercial sphere of human activity one can be wise or virtuous. We argue that one can be both: the profit motive can be consistent with virtue. Aristotle's concept of a moral mean is an apt description of entrepreneurship, in circumstances we spell out. An honest entrepreneur, in intending only to increase his own profits, cultivates the habits of awareness and alertness to opportunities to correct "mistakes" in resource allocation in the world around him. In every instance where a mistake is corrected, all parties to the exchange are made better off. To the extent that entrepreneurs improve the allocation of resources, they reduce waste and ensure that people do not use resources that other people value more. We consider two problems with defining entrepreneurship as virtue: intention and exploitation. The counterargument we offer is that honest efforts in euvoluntary exchange setting increase the division of labor, thereby expanding both the breadth and quality available to everyone in the society. Finally, we distinguish profit-seeking and rent-seeking, and concede that much activity that might pass for "entrepreneurship" is in fact vicious and harmful to society.
The Character of Profit and Loss: Entrepreneurial Virtues

Quintus Scaevola, the son of Publius, when he asked to have the price of an estate that he was buying named once for all, and the seller had complied with his request, said that he thought it worth more, and added a hundred thousand sesterces.

There is no one who would say that this was not the act of a good man; but men in general would not regard it as the act of a wise man, any more than if he had sold an estate for less than it would bring. This, then, is the mischievous doctrine, — regarding some men as good, others as wise... Cicero, *De Officiis* (Book III, Chapter 15)

1. Introduction

Entrepreneurs create products, take risks, and arbitrage price differences, in an attempt to earn profits, or revenues in excess of costs. Successful entrepreneurs are often accounted "wise," in the sense Cicero means above, but they could equally well be called calculating, or conniving. But then, can a calculating man also be good, or even virtuous? Cicero calls the wise vs. good dichotomy "the mischievous doctrine;" we will offer an argument that it is at least possible to be both wise and good. Then we will specify conditions under which entrepreneurship is more, or less, likely to reconcile profit-seeking and virtue.

We first describe what is meant by "virtue" in the context of commercial activity in pursuit of wealth, and rehearse briefly the argument for why entrepreneurial profit-seeking is per se inconsistent with virtue. The argument for inconsistency has two prongs, intent and exploitation.

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Either of these is separately sufficient, in the minds of critics, to establish fully the wise vs. good dichotomy.

The first argument--intent--notes that economists assume that entrepreneurs act out of self-interest. To be sure, profit-seeking might in principle have good consequences, but these are incidental to the narrow selfishness of the pursuit itself. Virtue as a character trait is a habit of right action, cultivated as an intentional product of reason. To be good, on this account, a person must intend good, rather than produce material benefits as a side-effect.

The second argument is that profits are per se exploitative and illegitimate. The successful entrepreneur, judged on the merits of commercial activity, must earn positive profits. But then only an unsuccessful entrepreneur could possibly be innocent of exploitation. If virtues are features of excellence in character, this implies a contradiction: One could be an excellent entrepreneur, and make profits, or one could be virtuous, and go bankrupt, but never both.

The paper proceeds as follows. In section 2, virtue, character, and entrepreneurship are defined briefly, and the definition of profit-seeking as creation and correcting “errors” is clarified. Section 3 poses the question of the necessity of intention, and the nature of the goals of entrepreneurs. We offer an answer to criticism that the benefits of entrepreneurship are incidental, and show that it is at least possible for successful entrepreneurs to achieve, and intend to achieve, social benefits. The fourth section poses the question of profit-seeking as per se exploitation, and discusses the nature of profit as a signal in market economies. To put some flesh on the abstract bones of this argument, we summarize a narrative taken from an article by R.A. Radford (1945), in which "extreme" profits are in fact a signal of the extent of the benefits that trade, and therefore the trader, can confer on others.
Section 5 distinguishes two types of commercial activity, rent-seeking and profit-seeking. In doing so we concede that much of the entrepreneurial activity labeled as vicious is, at a minimum, inconsistent with virtue. But there are also many instances of economic entrepreneurs, people who intended to create new value and who succeeded in doing so. The sixth section concludes.

2. Entrepreneurship and Character

2.1. Virtue as a Habit

There is a tradition of skepticism about the morality of market exchange, especially of the exchanges are motivated by a desire for obtaining wealth. Aristotle, in both the N.E. (McKeon, 1947) and the Politics, argued that exchange to obtain the things that the household--and by extension, the city--requires to satisfy basic needs is natural. Such exchanges can therefore be morally permissible, or even perhaps an excellence (in the sense of a techne, though not a virtue).\(^2\)

But for Aristotle exchange in excess of what is necessary to obtain the necessities of the good life--i.e., exchange motivated by wealth-getting--is unnatural and could never be a routine activity of a virtuous person. Thomas Aquinas gives a nuanced elaboration of Aristotle's argument.

It belongs to traders to be occupied with the exchange of commodities. But exchange is twofold: one form natural and necessary, either an exchange in kind, of commodity for commodity, or an exchange of a commodity for money, but in any case having for motive the necessity of living; and such an exchange does not belong to trade, but to ...the art in fact of providing a family or a State with the necessaries of life. There is another species of exchange, either of money for money, or of any sort of goods for money, the object here being not the necessaries of life, but gain; and this trade seems properly to belong to traders. Now the former exchange is praiseworthy, as ministering to a natural want: but the latter is justly blamed...

\(^2\) Aristotle, Politics, Book I, Chapter 3, n. 11.
Trade, considered in itself, contains a certain unseemliness, inasmuch as it does not essentially involve any honorable or necessary end. Still though gain, which is the end of trade, does not essentially involve anything honorable or necessary, neither does it essentially involve any element of vice, or aught that is opposed to virtue. Hence there is nothing to hinder gain from being referred to an end necessary or even honorable. And thus trade will be rendered lawful: as when one refers the moderate gain that he seeks from trade to the sustenance of his family, or to the relief of the distressed; or once more, when one applies to trade on behalf of the public interest, that the necessaries of life may not be wanting to his country, and seeks gain, not as an end, but as the wages of his labour. (Aquinas, *Summa Theologica*, #77). This conclusion, that trade is *not essentially opposed* to virtue, meant that traders had a respectable place in early medieval society.

It is important to remember that, for the Aristotelian tradition advanced by Aquinas, virtue is not a single moral choice. Virtue is an aspect of *character*, a habit of right action that is the consequence of conscious reflection and examination. In particular, virtue is a "mean" between too little of a quality and too much of that quality. Every person has a character, or a cultivated nature, which comes from the consistent application of principles that are the product of reflection and thought. Virtue is not the absence of vice, but is rather intentional and conscious. Moral virtues, in particular, are states of harmony that can be marred by excess or deficiency. Thus, neither the coward nor the fearless fool can be virtuous. The virtue—bravery—is a moral mean between these extremes.

This suggests the following definitions:

**Virtue**—a habit of right action, cultivated as an intentional product of reasoned reflection, in a social setting. Right action balances between vices, which are deficiencies or excesses of the particular virtue.

**Character**—a collection of traits of a person, both in terms of visible actions and the internal motivations that cause those actions. Character results from the repetition of choices in a variety

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3 Aquinas adds two further considerations later in the "Question": First, if one buys something for use, and later sells it, that is not "trading," even if the price later is higher. The motive is what constitutes "trading," not the act of buying and selling *per se*. Second, clerics should eschew so far as possible any buying and selling, no matter how innocuous, so as to avoid even the appearance of engaging something so potentially vicious as trading.
of settings, as a product of right reason. Virtues are individual habits of right action; character is the overall set of virtues and vices exhibited by a person.

A person of good character cultivates virtue in a way that promotes mutually beneficial exchanges through honest efforts and creative productivity. Thus, entrepreneurship is itself a habit, rather than a single act based on a principle invoked by a "moral feeling." Entrepreneurs acquire habits by repetition, and so Aristotle's conception of virtue is simply closer to what we see as the essence of entrepreneurship. But Aristotle's notion of character calculating a moral mean is also an apt description of the art of entrepreneurship. Aristotle's virtue of "liberality" lies between the shortcoming of meaness (taking too much, spending and investing too little) and the excess of prodigality (overspending, failing to take care to watch costs, and so one). Successful entrepreneurs cultivate a character of liberality. There are economic settings that encourage meaness or prodigality, of course, but in such settings entrepreneurial activities are not conducive to virtuous character, in ways we will elaborate.

Having defined virtue and character, we now turn to the definition of entrepreneurship.

2.2. Entrepreneurship as a Habit of "Right Action"

The origin of the idea of entrepreneurship is contested. It appears to derive from the French verb entreprendre, meaning “to undertake.” One of the first clear statements using the modern term and its modern meaning was J.B. Say (1803):

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4 The debate is not about when the word was first used, but rather when it was first used to mean what modern economists intend by the word. The French verb “entreprendre” means “to undertake,” making an entrepreneur one who undertakes something, generally something new, but the “thing” need have had nothing to do with commerce. In fact, the word appears to have been associated with creating musical or artistic “undertakings.” We would now more likely call such people “impresarios” or promoters.

There is a phrase in Sanskrit, “anta prerna,” which when spoken sounds something like “entrepreneur,” and means “self-motivated,” but it seems unlikely that this connection is
An entrepreneur is an economic agent who unites all means of production—land of one, the labour of another and the capital of yet another and thus produces a product. By selling the product in the market he pays rent of land, wages to labour, interest on capital and what remains is his profit. He shifts economic resources out of an area of lower and into an area of higher productivity and greater yield.

But this notion of simply buying low and selling high might simply be called “arbitrage,” another French loanword. Say’s conception is not wrong, exactly, but it ignores the most important aspect of entrepreneurship: imagining an alternative future. As Joseph Schumpeter put it:

The introduction [of new products] is achieved by founding new businesses, whether for production or for employment or for both. What have the individuals under consideration contributed to this? Only the will and the action; not the concrete goods, for they bought these—either from others or from themselves; not the purchasing power with which they bought, for they borrowed this—from others or, if we also take account of acquisition in earlier periods, from themselves. And what have they done? They have not accumulated any kind of good, they have created no original means of production, but have employed existing means of production differently, and more appropriately, more advantageously. They have “carried out new combinations.” They are entrepreneurs. And their profit, the surplus, to which no liability corresponds, is an entrepreneurial profit. (Schumpeter, 1934; 132)

Elsewhere, Schumpeter famously described entrepreneurs as more destructive:

“Entrepreneurs are innovators who use a process of shattering the status quo of the existing products and services, to set up new products, new services.” This was echoed, at a more popular level, by Peter Drucker: “An entrepreneur searches for change, responds to it and exploits opportunities. Innovation is a specific tool of an entrepreneur; hence an effective entrepreneur converts a source into a resource.”

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more than coincidental. The first printed use of the word was apparently in the French Dictionnaire Universel de Commerce of Jacques des Bruslons, published in 1723.

Richard Cantillon used “entrepreneur” in an economic sense in his 1755 book, Essay on the Nature of Commerce. Cantillon’s definition appears to have included someone who either purchased or created a product at a known cost for the express purpose of selling it later, though at an uncertain price. This would appear to encompass Aquinas’s “trading,” but also cobbler, coopers, hatmakers and others who manufactured products for sale.
The particular theory of entrepreneurship most useful for our purposes, one that combines the idea of different prices and innovations in imagination, is Israel Kirzner. Kirzner gives a classic description of the relation between profit, value, and entrepreneurship:

Let us consider the theorem which Jevons correctly called “a general law of the utmost importance in economics,” which asserts that “in the same open market, at any one moment, there cannot be two prices for the same kind of article.” …Now the existence of such a tendency [toward a single price] requires some explanation. If the imperfection of knowledge (responsible for the initial multiplicity of prices) reflected the lack of some “resource” (as where means of communication are absent between different parts of a market), then it is difficult, without additional justification, to see how we can postulate universally *a process of spontaneous discovery*…

We understand, that is, that the initial imperfection in knowledge is to be attributed, not to lack of some needed resource, but to fail to notice opportunities ready at hand. The multiplicity of prices represented opportunities for *pure entrepreneurial profit*; that such multiplicity existed, means that many market participants (those who sold at the lower prices and those who bought at the higher prices) simply overlooked these opportunities. *Since these opportunities were left unexploited, not because of unavailable needed resources, but because they were simply not noticed, we understand that, as time passes, the lure of available pure profits can be counted upon to alert at least some market participants to the existence of these opportunities.* (Kirzner, 1978; emphasis added)

Kirzner defined entrepreneurship as “awareness,” the constant searching for profit opportunities. But Kirzner conceived of errors much more broadly than the above passage would suggest. Rather than simply “correcting” errors in the price system, and causing the convergence of prices of a single existing commodity, entrepreneurs imagine alternative futures, new products, and possible ways of organizing production.

It is difficult to overstate the importance of this distinction. An entrepreneur does not (just) take advantage of errors (i.e., differences) in prices. An entrepreneur cultivates a character of alertness, looking to anticipate what consumers want. But that means that the system is ultimately driven (though perhaps passively) by consumers, not entrepreneurs. Entrepreneurs are the active agents in the system, but consumers decide what firms produce and which productive activities will be rewarded and which punished.
Ultimately, entrepreneurs must (to paraphrase Kirzner) try to “see around the corner. Successful economic entrepreneurs are alert to entirely new possibilities, to products and innovations that consumers may well not even be aware that they could have, much less want. Steve Jobs, of Apple Computer, famously observed that entrepreneurs could not rely on static conceptions of “demand”: “You can't just ask customers what they want and then try to give that to them. By the time you get it built, they'll want something new.” (*Inc.*, 1989).

A decade later, Jobs went further: “But in the end, for something this complicated, it's really hard to design products by focus groups. A lot of times, people don't know what they want until you show it to them.” (*Business Week*, 1998). This view, if it is correct, suggests a problem with defining entrepreneurship as a virtue, at least from the perspective of those other firms and enterprises still trying to make what people used to want, before they were shown what they really wanted but didn’t know. The Sony “Walkman” was an extremely popular (and profitable) device that allowed people to move around or even exercise while listening to the radio or to cassette tapes. At one point the Walkman captured more than 50% of the “mobile music” market.

But then MP3 players were invented. And even though people didn’t know that MP3 was how they wanted to buy, store, and carry their music, it turned out to be so. The most successful MP3 player, for more than a decade, has been the iPod made by Apple. Steve Jobs, and the Apple engineers, imagined a different arrangement of productive resources. None of the resources

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5 MP3 is short for MPEG 3, an abbreviation for “Motion Picture Expert Group” codings. Codings are means of reducing the amount of information (bits of stored digital information) to encode a song without losing quality. The first patents for MP3 encodings were issued in the U.S. in the late 1980s and the early 1990s. The first commercially viable MP3 players went on sale in the late 1990’s, and by 1999 they were relatively common in stores. The first iPods from Apple were released in January 2001; by the end of 2002, 600,000 had been sold, at prices exceeding $400 in nominal terms.
needed to be invented, and none of the digital processes for storing the music were especially
difficult or innovative. But the package, the iPod and other product like it, was something new.

And what about the Walkman? Sony lost billions of dollars, and was unable to offer a
competitive product for much of the period when MP3 players were being sold to people who were
buying one for the first time. Sony laid off at least 10,000 workers, and closed two large
production facilities, causing at least 100,000 people to suffer significant economic harm. If Steve
Jobs caused that much harm, how could entrepreneurship be a virtue? Most importantly, perhaps,
the harm was intentional: Apple had specifically targeted Walkman as the consumer electronic
device they wanted the iPod to replace.

We turn now to consider intentions.

3. Intention

Must the entrepreneur consciously intend to improve the welfare of his customers? Or is it
sufficient that an honest entrepreneur, even one intending only to increase his own profits,
cultivates the habits of awareness and alertness to opportunities to correct "mistakes" in resource
allocation in the world around him?

One answer has to do with unpacking the concept of "self-interest." If a person is an
altruist, then serving others is what makes that person happy. It is quite true that an altruist who
tries to serve others makes other people better off, assuming the altruist is competent and effective
in the activity selected. But why is this any less an accident of intention than the effective and
honest entrepreneur? One could imagine Mother Teresa having two or three glasses of wine, and
admitting, "My main concern for other humans is that I can avoid going to hell, and be assured of
going instead to heaven." Would we think less of her charity, and good works, if her primary intention were her own salvation?

George Stigler famously claimed that dichotomy is actually quite false: the problem is usually not either self-interest or altruism, but a combination. As Stigler (1963) put it: "The violent endeavors of an athlete to defeat his rivals are much admired, providing the contest is more or less fair, even though the winner is expected not to say, 'I am glad I won chiefly because I'm vain, but secondarily for the honor of Sheboygan High School.'" We all understand the athlete may be motivated by personal glory, and yet we don't blame the athlete for his intentions to defeat his opponent.

Further, it is quite possible that the intentions of the entrepreneur are precisely the betterment of mankind, and that profits are just a by-product or side effect. A famous example is the creation of "Kellogg's Corn Flakes," one of the most popular, and profitable, breakfast cereals in the world. In 1894 two brothers, J.H. Kellogg (a physician and director of a sanitarium at Battle Creek, Michigan) and W.K. Kellogg tried to design a recipe for a breakfast food that would suit the needs of the vegetarian diet prescribed by their Seventh Day Adventist religious beliefs. Dr. Kellogg also believed that spices, sugars, and other additives were unhealthy and even "roused the passions."

The brothers had prepared a wheat mash, which they happened to leave out while they tended to some other duties in the sanitarium. On their return, they found that the mush had gone quite stale, but they nonetheless processed the mush through rollers to make a kind of wheat breakfast cracker. Unexpectedly, the wheat crackers fragmented in "flakes" on being cooked. Rather than throwing the failed crackers away, the Kelloggs recognized that their mistake was actually an important innovation. Experimenting with other grains, they eventually settled on corn
as the primary ingredient, and called the product (unimaginatively) "Corn Flakes." Today, nearly 120 years later, Kelloggs Corn Flakes sells more than 8 million boxes per week worldwide, and the innovation of "flakes" as a way of making breakfast cereals is involved in perhaps 10 times that amount of sales each week.

Were the Kelloggs virtuous, or entrepreneurial, or both? Their intentions were to improve the diets and health of the patients in the sanitarium, but they also aspired to popularize a cheap and healthy breakfast for the masses, it is clear. They appear to have had no explicit objection to making a fortune, but their goals were to produce a product that would benefit other people. Further, and no less important, they cultivated habits of hard work, accurate research methods with record-keeping, and even "liberality." They did not overspend, and were in fact quite thrifty in their habits. But once they hit upon a successful recipe, they went all in, investing in expansion and inventing a series of mechanical improvements to the production process.

Our conclusion, then, in terms of the analysis of intent is this. An intention to do good is not of itself virtuous, at least not in the realm of economic activity, because success requires a technical excellence at creation of useful products and controlling costs. A good person must also be wise. On the other hand, the intention to earn profits is not in itself vicious, because the strenuous exertion of honest effort in a successful attempt to create useful products and control costs can be virtuous. Intent has little to do with the essence of entrepreneurial virtue.

4. Exploitation

There are several forms of the argument that profit is inherently exploitative, or (in effect) coercive. On this account, even if the entrepreneur intended only to benefit society, the fact that profits are extracted is per se evidence of exploitation.
The standard form of this argument is that of Marx, derived from Adam Smith's "labor theory of value." In this view, wages are the fundamental payment for the value of goods created, and other "payments" (interest, payments to land, profits) are diversions from what should properly be labor's share.

Marx claimed that in the pre-capitalist economy, workers created commodities, sold these commodities for money, and then used that money to buy other commodities. In the capitalist economy, by contrast, the labor of workers itself becomes a commodity that is bought and sold, so that the factory owner (for example) uses money to hire labor at an hourly rate, and then takes the commodities produced in the factory and sells them for money. But there is no necessary connection between the wage required to buy the labor commodity (the subsistence wage) and the actual value of the labor (embodied in the value of the resulting commodity sold by the entrepreneurial capitalist). Thus, the factory owner takes the excess of his revenues over his costs—profits—out of the value created by labor. Labor is then exploited in precisely the ratio that profits result: more profits, more exploitation.

Many authors have argued this point, but the simplest and most persuasive refutation (in our opinion) is that supplied by Reisman (1985). The argument goes like this: Marx (and Smith) are quite right about the justness of the distribution of the "surplus" in the pre-capitalist stage of economics all going to the person who created the commodity. But the mistake is calling that surplus a "wage." The person who makes a new commodity to sell it is not a worker at all! He is an entrepreneur. And that surplus is not a wage, but is instead profit.

True, the worker who makes shoes, or grows barley, is working for himself. But the payment he receives when the product is sold is his revenue, from which he subtracts, in effect, the wages he paid himself. What is left over is profits. If the worker earns substantial profits from
selling shoes, or barley, it seems absurd to imagine that he is exploiting himself. And if some Marxist scholar suggested that it would be more virtuous to stop earning so much profit, the shoemaker would think the scholar was insane.

And the shoemaker would be right. He is not a worker, but an entrepreneur. Thus, the exploitation story should be turned entirely on its head: workers choose to commodify, and sell, their labor if and only if their profits from doing so exceed the profits they could earn by being in business for themselves, and making products to sell on their own.

Of course, contractual relations for either entrepreneurs or workers could well be exploitative, if they involve coercion or monopoly power in an exchange partnership. This asymmetry in bargaining strength is a feature of a variety of economic settings, and is the subject of a considerable body of work asking whether an exchange is euvoluntary, or truly voluntary. This discussion, while important, is outside the scope of the present effort. Our focus is on the question whether profits are per se exploitative. They are not.

The argument so far in this section is quite abstract. To put some flesh on the abstract bones of this argument, we summarize a narrative taken from an article by R.A. Radford (1945), in which "extreme" profits are in fact a signal of the extent of the benefits that trade, and therefore the trader, can confer on others, provided the exchange is euvoluntary.

During World War II, British economist R.A. Radford was captured and placed in a German P.O.W. camp. Radford noticed the universality of exchange in various camps, and (as an economist) he knew that exchange, in the presence of full information and in the absence of coercion or fraud, always makes both parties to the exchange better off. The interesting thing about the prison camp setting is that each prisoner had precisely the same endowment or total wealth.

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6 See Munger (2011) and Guzman and Munger (2014).
The reason that we know this for certain is that each prisoner received (a) identical (and often scanty) daily rations from what Radford delicately calls “the detaining power”; and (b) sporadically, but regularly enough to be relied upon, the contents of a Red Cross packet: tinned milk, jam, butter, biscuits, tinned beef, tinned carrots, chocolate, sugar, treacle, and cigarettes.

What is meant by “makes both parties better off” is this. If I like a tin of carrots more than a tin of milk, and you like milk more, we can trade. This is actually quite important: Not trading would be a “mistake”! There is a “surplus” of value that results from correcting the mistake in allocation that would result from my consumption of the milk you value. Your consumption of the carrots that I value is likewise a waste, a mistake. Allowing exchange does nothing to create more food overall, but the total welfare of the group is improved if each person is allowed to correct mistakes.

Radford makes a striking observation in this regard, adding a moral dimension: “Very soon after capture people realized that it was both undesirable and unnecessary, in view of the limited size and the equality of supplies, to give away or to accept gifts.... ‘Goodwill’ developed into trading as a more equitable means of maximizing individual satisfaction.” In other words, these desperate people realized exchange is more equitable than relying on gifts or charity. The reason is that truly voluntary trades always leave both parties better off. The surplus created by the exchange is divided somehow between the two traders.

Adding a third party intermediary, the entrepreneur, appears to make things more complicated, but that appearance is misleading. A middleman (entrepreneur) specializes in helping people correct mistakes by making exchanges, provided the exchanges are euvoluntary. Euvoluntaryness means that no exchange is possible unless it produces value for both parties. The entrepreneur stands in the middle, facilitating exchange and engaging in a greater volume of
exchange. There is an important difference, however, and that lies at the heart of the distinction between the exchanges people make to acquire the goods and food that make their lives better (a value in use) and the entrepreneur’s objective, which is to engage in trades that yield a surplus for the sake of creating a surplus, not because he is interested in using the goods or food for their own sake.

Radford (1945) describes a priest with a sharp eye for exchanges: “Stories circulated of a padre who started off round the camp with a tin of cheese and five cigarettes and returned to his bed with a complete [Red Cross] parcel in addition to his original cheese and cigarettes.” These are clearly profits, in the context we have been discussing. Did the "itinerant padre" exploit the other prisoners?

The point of the story seems to be no, though Radford does intimate that the prisoners in the P.O.W. camp thought that the resulting distribution (padre gets an extra Red Cross packet as profit) was unjust. They had no quarrel with any of individual transactions, but only with the consequent wealth differences. This seems a paradox: how can an unjust total result come from many transactions, each of which was truly voluntary and therefore just?

Our argument is that the entrepreneur is engaged in a true art, under certain conditions. One of these conditions, an important necessary condition, is that the exchange is truly voluntary on both sides. If exchange is euvoluntary, then entrepreneurs are engaging in a techne, and their actions can be virtuous. There is nothing exceptional about any one of the trades, nothing different from the bilateral exchanges that might take place between men who happened to have adjacent bunks in the barracks. In fact, all the exchanges—if they were euvoluntary, as appears to be true from the description—would have been beneficial for each and every trading partner, if the motive of the padre had been to obtain food items or other things for his own use. What
transforms the exchange from obtaining stock for use and obtaining stock for further exchange, to make money, is the *techne* of exchange arbitrage.

But why would this matter to the people who were trading with the padre? Why would they care what his motives were, so long as the exchange was euvoluntary and the terms were fair? The padre created value at every step in the process. In fact, he likely created more value—for others—than anyone else in the camp. He did this by finding (say) Allan, who was willing to *pay six or fewer cigarettes* for a tin of beef. If the padre earlier met Barry, who had a tin of beef and would *sell for three or more cigarettes*. Of course, if these two traders had happened to meet each other, they would have exchanged directly. But finding just the right person to trade with is time-consuming at best, and may not happen except by chance. The padre, by searching across trades, arbitrated the difference: He could sell the beef to Allan for five cigarettes after buying it from Barry for four. Thus, both Allan and Barry are better off by at least one cigarette and the padre “profits” one cigarette by finding the voluntary exchange opportunity.

One could object that if Allan and Barry had trade directly, they would have split a surplus of three: the most Allan would pay is six, the least Barry would accept is three. But in the actual event, dealing with the padre-middleman, they only got one cigarette each, because the padre took one cigarette in profit. But neither of the two trades—padre pays four cigarettes to Barry, padre sells for five cigarettes to Allan—was anything other than euvoluntary. And either of the two trades, alone, would be acceptable to an outside observer. The only objection comes when the padre both buys and then later sells, because that means his motive was to create value in exchange rather than value in use.

And that indicates what we will argue is the proper conclusion about virtue in entrepreneurship. So long as the entrepreneur creates value in every exchange, then his actions are
consistent with virtue. And the more value-creating exchanges the entrepreneur engages in, the more value he creates. This conclusion follows directly from restricting transactions to being euvoluntary.

5. Rent-Seeking and Profit-Seeking

Of course, there is more to the act of entrepreneurship, as it is conceived by Schumpeter and by the Austrian economists. Entrepreneurship is an act of conceiving something new, of imagining something. This is more than a techne; true entrepreneurship in the larger sense of creation is phronesis, or practical wisdom. Steve Jobs, in recognizing that people wanted something they had never even imagined owning, was seeking profits by cultivating a virtue, phronesis.

The problem we face is that many acts that appear on their face to be entrepreneurial are something else: rent-seeking. And rent-seeking is never virtuous. "Rents," as opposed to the classical notion of profits, require state action and protection. Thus, while economic agents can be seduced into political entrepreneurship by the blandishments of a state apparatus offering subsidies or protections, economic or commercial entrepreneurship is not subject to the same problems. Economic history is replete with instances of political entrepreneurs exploiting the powers of the state, to be sure. But there are also many instances of economic entrepreneurs, people who intended to create value and who succeeded in doing so.

We can combine the conclusion of the previous parts of the paper with the argument we intend to make in the current section:

Entrepreneurs are virtuous if the exchange relations they enter into (1) are euvoluntary, and
(2) pursue profits as opposed to rents. The requirement that the exchanges be euvoluntary rule out exploitation. The distinction between rent-seeking profit-seeking ensures that there are new social value being created.

*Profit-seeking* involves *creating a new product*, a better product, or a cheaper product that consumers want to buy. The competition is positive-sum. Consequently, profit-seeking (for economists, at least) generally implies net positive effects.\(^7\)

*Rent-seeking* involves *manipulating the rules* of competition to one's own advantage, or pursuing some other artificially created prize or benefit created an authority with the power to effect this transfer. The competition is at best zero-sum, and because substantial resources are generally consumed by the competitive activity may be negative sum with a large magnitude. Consequently, rent-seeking is generally associated with negative effects.

To present our argument at the start, here we will claim that the difference between these concepts not only involves the origin of the profits or rents that are being sought after, as has been discussed by Tullock (1967), Buchanan, et al. (1980) and Tollison (1982), though that distinction is important. Tollison (1982) defined rent-seeking as competition for an artificial prize, created by state action, rather an increase in value for the society. The money for the “rent” is taken from tax revenues, or else is created by laws the suppress competition or protect favored entities. Rather than creating value, rents are at best a transfer. And to the extent that competition in seeking after the rent dissipates some, most, all, or even more than all the amount of the transfer, rent-seeking can even destroy value.

This is a very different activity from profit-seeking, which involves entrepreneurs undertaking activities result in having a new, different product in the marketplace as a result of rearranging productive resources. Successful profit-seeking creates new value, expanding the total

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\(^7\) Assuming externalities are internalized by bargaining, regulation, or taxation. Otherwise, it is perfectly possible that a profit-maximizing producer may cause net harm to the society. But the possibility of net harms is less likely than a reading of the "market failure" literature might lead one to believe. It is certainly true that the invention and popularization of the internal combustion engine as a means of moving cars, trucks, and buses created a problem of pollution. But the net effects have still been enormously positive.
benefits to be distributed from a social point of view. In this context, the extent of profits—and losses—in different activities conveys information that is itself of very significant social value. This information about consumers want, and don't want, is extremely valuable, but it is produced nearly for free by market processes.\(^8\) There is no other way for new generations of inventors, engineers, and innovators to learn of the likely best fields of study in which they might acquire training, expertise, and experience.

Profits and losses thus assume a social function in the sense that they guide the allocation of resources in the economy (Mises 1951; Kirzner 1978). The subjective nature of the individual decision-making process, and the fact that it is undertaken within the context of an uncertain environment is especially important to underscore regarding these issues. The difference between profit-seeking (which if the exchanges themselves are euvoluntary is consistent with virtue) and rent-seeking (which is always destructive) depends on the institutional environment within which entrepreneurs interact (Baumol 1990).

Folsom (1989) gives an example of both profit-seeking and rent-seeking, occurring at the same time in the same industry, early steam ships carrying passengers and cargo. Folsom's account has four main characters: two rent-seekers (Cunard and Collins) and two profit-seekers (Vanderbilt and Inman). The account is worth quoting at some length.

Those who tried to succeed in steamboating primarily through federal aid, pools, vote buying, or stock speculation we will classify as [rent-seekers]. Those who tried to succeed in steamboating primarily by creating and marketing a superior product at a low cost we will classify as [profit-seekers].

[Cunard] convinced the English government to give him $275,000 a year to run a biweekly mail and passenger service across the Atlantic. Cunard charged $200 per passenger and 24 cents a letter, but still said that he needed the annual aid to cover his losses…

\(^8\) See Mises (1952), Kirzner (1978) and Carden (2009; 2011) for links between profit and loss and “right” action by entrepreneurs.
[Collins] began using these same arguments for Federal aid to the new U.S. steamship industry. He said that America needed subsidized steamships to compete with England, to create jobs, and to provide a military fleet in case of war. If the government would give him $3 million down and $385,000 a year, he would build five ships, deliver mail and passengers, and outrace the Cunarders from coast to coast...[H]e built four enormous ships (not five smaller ships as he had promised), [and] covered the ships with plush carpet and brought aboard olive-wood furniture, marble tables, exotic mirrors, painted glass windows, and French chefs. [The] ships used almost twice the coal of the Canard Line...

With annual government aid, Collins had no incentive to reduce his costs from year to year. He preferred to compete in the world of politics for more Federal aid than in the world of business against price-cutting rivals. In 1852 he went to Washington and lavishly entertained President Fillmore, his cabinet, and influential Congressmen. Collins artfully lobbied Congress for an increase to $858,000 a year.

It took Cornelius Vanderbilt, a New York shipping genius, to challenge this system. In 1855, Vanderbilt offered to deliver the mail for less than half of what Collins was getting. Congress balked—it was pledged to Collins—so Vanderbilt decided to challenge Collins even without a subsidy. “The share of prosperity which has fallen to my lot,” said Vanderbilt, “is the direct result of unfettered trade, and unrestrained competition. It is my wish that those who are to come after me shall have the same field open before them.”

Vanderbilt’s strategy against Collins was to cut the standard first-class fare to $80. He also introduced a cheaper third-class fare in the steerage...All this was too much for Collins. When he tried to counter with more speed, he crashed two of his four ships, killing almost 500 passengers. In desperation he spent one million dollars of government money building a gigantic replacement, but he built it so poorly that it could make only two trips and had to be sold at more than a $900,000 loss. (Folsom, 1987: 6-7)

It is clear that in this story rent-seeking has negative social effects. The problem is not simply one of a transfer of resources (rents). The existence of the rent motivates many talented agents to go after it. It is this contest that leads to the dissipation of the rent and to overall waste. It is important to emphasize the prisoner’s dilemma nature of this problem: while in the aggregate these activities generate a significant negative externality, from the perspective of the rent-seeker entrepreneur himself his decision is actually rational and beneficial.

6. Conclusion
In setting up the conception of entrepreneurial virtue, we have tried to isolate the conditions under which profit-seeking is a socially positive force. We have done this in a rather roundabout way, by identifying the conditions under which entrepreneurship is a virtue. Those conditions are (a) exchanges are euvoluntary, so that the products and services produced and sold create real value for consumers; and (b) the goals of the entrepreneur really are profits rather than rents obtained by suppressing competition through monopolizing tactics or using the power of the state.

The reason we have spent all of this space developing these two conditions is that they flesh out what is meant by the “character” of the entrepreneur. Pro-market theorists generally simply assume that the two conditions we specify are met, but this is by no means obvious. The temptations to seek rents may be irresistible, particularly if others are seen to be seeking rents. And the gains that can be had by attempting to fix price and other rent-seeking activities may yield much higher returns than trying to imagine, produce, and market new and innovative products.

Interestingly, Adam Smith—often seen as the chief advocate for capitalism—had quite a nuanced view of the “character” of business people. He recognized the potential for attempts at collusion if "people of the same trade" meet together, and did not think that any special trust to forebear the benefits of price-fixing was justified. Smith's main point, however, was that society should try to prevent the formation of guild-like arrangements, or to divest them of power where they already exist. If workmen, shopkeepers, and entrepreneurs can be forced compete, with none of the exclusive privilege conferred by guilds or monopoly corporations, they will be forced—perhaps against their own urges to rent-seek—to depend upon their character!

This is a remarkable claim, and demonstrates just how far into the human element of market competition Smith was able to see. Smith appears (Otteson, 2002; Hanley, 2009) to have

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9 Smith, 1776, Bk I, Chapter X, Paragraphs 82-86.
intended “character” to have at least two shades of meaning. One was habit, in a sense very close to the Aristotelian notion of virtue we discussed earlier. But the other was reputation, or the perception that other people had that this person could be relied upon to carry out promises.

The two notions are related, of course. But Smith saw the “character” of market participants to be plastic, or at least contingent. Everyone was capable of acting virtuously, but everyone was also capable of acting badly. The institutions of the society played a key role in determining what sort of character a person cultivated. Like the famous difference between the porter and philosopher, Smith thought character was a product of development rather than determinism. Smith’s contribution was to notice that the sanction on entrepreneurs exhibiting bad character would take the form of loss of business. Character, and virtue, are rewarded with profits, and vice and deceit are punished with losses.

In some ways, that is the heart of his argument against mercantilism: it harms the character of economic agents who, if forced to compete, would rely on their character as a way of attracting and holding business opportunities. True, people were only too happy to take advantage of opportunities to rent-seek and “contrive” schemes to cheat customers, if they could get away with it. And in the mercantile guild system these opportunities were everywhere. Smith’s contribution was his recognition that, in a competitive system with the protection of guilds swept away, people would be forced competition and their own need for social esteem to behave better.\(^{10}\) We are

\(^{10}\) Perhaps the clearest statement of this view comes from Adam Smith’s 1790 revised edition of Theory of Moral Sentiments. As Hanley (2009) sees it, Smith had written the Theory of Moral Sentiments and then Wealth of Nations as if they were a single work, and they cannot be read separately. An excessive and exclusive focus on the “corruption” of beneficence and virtue in Wealth of Nations has led some to conclude that capitalism is simply inconsistent with virtue, in Smith’s view.

But as Hanley (2009) argues, the fact that Smith went back to Theory of Moral Sentiments and added a new section, Section VI, whose subject was virtue ethics, shows that Smith thought that there was a problem of corruption, but that he also thought that was a
much more likely to see people rely on character, and cultivate a habit of entrepreneurial virtue, if the market system rewards virtue and the state is prevented from punishing virtue.

It is useful to close with quote, one that in some ways mirrors Cicero's observation about the wise man and the good man. The quote comes from Deirdre McCloskey's book The Bourgeois Virtues.

Modern capitalism does not need to be offset to be good. Capitalism can on the contrary be virtuous. In a fallen world the bourgeois life is not perfect. But's better than any available alternative…

Countries where stealing rather than dealing rules become poor and then remain so…It doesn't matter what kind of predation/stealing it is--socialist stealing such as in Cuba, or private/governmental stealing such as in Haiti, or bureaucratic stealing such as in Egypt of today or of ancient times, or…stealing at the point of a pen by CEOs in America during the 1990s. By doing evil we do badly. And we do well when we do good.

Capitalism, I claim, nourishes lives of virtue in the non-self-interested sense, too. The more common claim is that virtues support the market…[But even that is hard for economists, because] it goes against our professional impulse to reduce everything, simply everything, to prudence without other virtues…But I go further….I say that the market supports the virtues. (McCloskey, 2007; pp. 1-3; emphasis added).

We are not so sure about "capitalism." Capitalism, and for that matter markets, are systems. To be fair, elsewhere McCloskey notes that "commercial societies make virtuous citizens (McCloskey, 2004; 334). The system of commercial interaction, then, both rewards, and creates an opportunity for citizens to cultivate, virtue.

solution: the virtue of the character of the wise, prudent man, whose main characteristic is beneficence.

In the same vein, Otteson (2002) argues that Smith’s two works cannot be separated without seriously limiting the value of each work. According to Otteson, Smith was confident that morality and moral judgments would develop in ways that disciplined the “sentimentality” and corruption of market actors.
Hayek (1976) was famously concerned whether concepts like "justice" of "virtue" could usefully be associated with systems, or outcomes. At best, then, we might ask whether different systems promote or retard the development of character and virtue. And on these grounds our conclusions are quite similar to those of McCloskey, though on the much narrower grounds of considering the virtue and character of human agents called "entrepreneurs." We have identified two conditions that are together sufficient (though perhaps not necessary) for market entrepreneurship to "nourish" virtue. The first condition is euvoluntarity, or the requirement that the conditions of the exchanges are truly voluntary, without force, fraud, or regret. The second condition is that entrepreneurs pursue profits rather than rents, meaning that accounting "profits" must derive from the creation of new value, either from arbitrage or innovation, rather than government-sponsored theft.

If these conditions are met, then entrepreneurs cultivate virtues such as diligence, honesty, liberality, opulence (yes, it's a virtue, in moderation!), and prudence. So entrepreneurial virtue is rewarded in (some) market settings. The difficulty, and we admit that it is a difficulty, is that an additional virtue is required: forbearance. There are some "profit" opportunities (where we use the accounting, rather than economic, sense of the word "profit") that a virtuous entrepreneur must pass up. Commodore Vanderbilt would have had an easier life, and earned more money much faster, if he had succumbed to the temptation to engage in rent-seeking. Instead, he practiced the virtue of forbearance, forsook rents, and created a product--steamship passage--which was cheaper, faster, and actually safer than anything that could be provided by the subsidized carriers.

A more recent example of forbearance can be found in the recent decision by a maker of video game "apps" to withdraw his product from the market. There had been no complaints; in fact, the product was drawing ad revenues of $50,000 per day. But the entrepreneur, Dong
Nguyen, took down the app and stopped selling it. Why? A reporter for Forbes (Nguyen, 2014; no relation) tells the story:

The mysterious developer of the world’s most popular free app, who drew global attention this past weekend with his sudden decision to remove it, tells Forbes that Flappy Bird is dead. Permanently.

“Flappy Bird was designed to play in a few minutes when you are relaxed,” says Dong Nguyen, in an exclusive interview, his first since he pulled the plug on the app. “But it happened to become an addictive product. I think it has become a problem. To solve that problem, it’s best to take down Flappy Bird. It’s gone forever.”

In killing Flappy Bird for what he maintains are altruistic reasons, Nguyen is walking away from a jackpot. An article in the Verge last week estimated his daily take from in-app advertising at $50,000. Nguyen declined to confirm that number. “I don’t know the exact figure, but I do know it’s a lot.”

Of course, it is hard to figure out the real reasons why Nguyen killed the highly profitable app. He may have been facing legal troubles, or been worried that the product was going to tank anyway and decided to cash in on the publicity. But it is actually plausible to conclude that the product was addictive (Pinola, 2014), and was creating social harm.

That is the essence of the forbearance that is required for entrepreneurial virtue. Not that one shouldn't do something because we'll get caught, or pay a fine. There are some things--socially harmful things like sell bad products or engage in rent-seeking--that a virtuous person just won't do. Because it is wrong to do those things. A person of good character won't do those things. And in the long run, having a good character is more valuable, and possibly even more profitable, than seeking short-run profits to the exclusion of all else. Some quick feedback:

Your virtue assessment is correct. The community of successful entrepreneurs is filled with people that put craftsmanship, the creative process, the customer, or other factors ahead of pure profit making.
One excellent example of this is Mark Zuckerberg and Facebook's "Hacker" culture. The culture at Facebook emphasizes "smart fixes" and "quick decision making", creating "cool products" and solving the user's problems in an efficient way over any kind of profit motive. The idea is "build great products and attract users, and the money will easily come"

Elon Musk made several hundred million off of Paypal. Instead of living a cushy life and relaxing the rest of his days, he invested ALL of his money (and went into significant debt) into creating Space X and Tesla Motors and Solarcity ALL AT THE SAME TIME. He was able to provide leverage to grow those companies with his personal wealth that would NOT have happened without him.

Perhaps this is why Silicon Valley and most startups have such a distaste for typical MBA students? The MBA student is studying business from a much more profit seeking perspective rather than a "passion for creating good products."

Many of the products that have created the biggest impact in our recent history would not have been created without these virtues. Web Browsers, Linux, Twitter, Facebook, all created by people more interested in creating something "cool and new" than in pure profit. They have a long-term horizon, and a short-term horizon would have quickly resulted in them killing their products.

Some additional questions worth exploring:
Our current political climate (and that of the last 50 years) is ratcheting towards increasing socialism. In a democratic-capitalist-socialist system, where votes to control socialized aspects of the business system can be bought by the highest bidder... are we inevitably going to kill the golden goose?

Is there another government-civilization configuration that would still provide room for the "hacker" virtuous entrepreneur to create, but control for the influence of entrenched players? Will virtuous entrepreneurs want to work for the party (as China has recruited most of the successful entrepreneurs to the high decision making bodies of the party)? Or for the king (as Putin would like, and the King of Jordan, and now the kind of Saudi Arabia)?
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