The role of market structure as a lens to differentiate strategy from entrepreneurship

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ABSTRACT
This paper differentiates strategic management from entrepreneurship by suggesting that strategic management is the search for how to apply resources within a market to generate economic rent while entrepreneurship is the search for a market where given resources will generate economic rent. The market structure is how the market factors – the elements of a market – are arranged and relate to each other within the market. Traditional strategic literature views the market structure as an exogenous variable, both given and fixed. The resource-based view of strategy (Barney, 1991; Mahoney and Pandian, 1992; Wernerfelt, 1984) focuses on how resources are allocated to firms and how firms’ choose to use those resources. Firm competitiveness is affected by market structure because assessments of value, rarity, and barriers to imitation are linked directly or indirectly to market factors (Dierickx & Cool, 1989). This paper suggests that entrepreneurship takes a different approach. Entrepreneurs view the market structure as a variable of interest that can be manipulated and altered as needed to create rent-generating opportunities (Kirzner, 1982). This conceptualization of entrepreneurship as a market based view of strategy flows directly from Schumpeter’s work on creative destruction (Schumpeter, 1934). The focus of the entrepreneur is on selecting or creating a market where a given resource set can be used to maximize economic rent (Lachmann, 1997; Hitt & Ireland, 2002).
INTRODUCTION

Beer, the Bible belt, and Impact, Texas

West Texas was a dry parched place in many ways in 1960. The daily high temperature was up to 106 degrees Fahrenheit by June (NOAA, 2005), and liquor sales were illegal in the surround 150-mile radius area (Whitaker, 2001). Texas had adopted local option following the 1933 repeal of prohibition in the U.S. Constitution (Gould, 2002). No city in the nine counties surrounding Abilene had voted to sell liquor because of the area’s conservative Bible belt roots (Whitaker, 2001). Legal efforts to stop liquor sales gave impetus to illegal production of homed liquor or moonshine and the Texas Liquor Control Board discovered 68 moonshine stills in 1962 (O’Neal, 1984).

Another alternative emerged when Abilene, Texas businessman Dallas Perkins incorporated his 20-acre poultry farm and an adjoining 27-acres into the town of Impact, Texas in 1960 (Troesser, 2004). The newly-incorporated town then held a local option election and Perkins, his family, and neighbors voted to allow liquor sales in Impact by a vote of 18-2 (Whitaker, 2001). The city of Abilene took the town of Impact to court and the Texas Supreme Court upheld the incorporation and local option election in 1963 (Handbook of Texas Online, 2002). Alcohol sales opened with a boom in Impact with first month’s sales of $463,000 (Haymes, 1995). Impact grew with the opening of a second liquor store and a gasoline station and the town’s population crested at 61 in 1970 (Troesser, 2004). The boom times for Impact ended when Abilene passed liquor sales by local option in 1978 (Whitaker, 2001). The effect on Impact was immediate. The liquor stores and the gasoline station closed and the population of Impact had declined to 39 at the end of the 21st century (U.S. Census Data, 2000).
Entrepreneurs and market creation

The rise of Impact, Texas illustrates the central point of this paper: Entrepreneurs attempt to create the necessary market structures to enable their concepts to succeed. Market structures are both the set of elemental factors involved in the production and distribution of goods or services and the set of relationships present among those factors. This need to create market structures contrasts with conventional views of strategy as the search by the strategists for the match between existing resources and available markets that allows the firm to maximize the economic rent of those resources (Rumelt, Schendel, and Teece, 1991, 2005). The entrepreneur creates the market structure, the strategists assumes that market structure is given. Market structures are endogenous to the entrepreneurial model and exogenous to the strategic model.

This paper explains and explores market structures and elucidates the role of market structure in entrepreneurial thinking. The paper first defines market structures and differentiates market structures from market factors or industry structure. The role of market structures in strategy and entrepreneurship is then explored and discussed. The concept of market structures is then used to define a market based view of entrepreneurship in contrast to the resource-based view of strategy (Barney, 1991). The paper concludes with a discussion of the impact of these ideas on future research and in practitioner application.

MARKET STRUCTURE

Market structures are critical to understanding the exchanges of goods and services and are a central theme of the industrial-organizational (I-O) economic view of strategy (Bain, 1956; Mason, 1939). This section will define market structures and differentiate market structures from market orientation, market factors, or industry structure.
Market structure defined

Market structure is both the set of elemental factors involved in the production and distribution of goods or services and the set of relationships present among those factors. Market factors are environmental and competitive elements that constitute a firm's external environment and constrain firm action (Porter, 1980). Market factors include environmental items such as inflation, and technological or legal shifts and competitive factors such as competitors, entrants, and rivalry dynamics. Significant business strategy literature is dedicated to examining the effect of market factors on firm performance, specifically Porter's five forces industry model and the technology management literature (Porter, 1980; Sherman, Hitt, Demarie, and Keats, 1999).


Market structures differentiated from market orientation, market factors, or industry structure

A firm's market structure differs from its market orientation in that market orientation is focused on a firm's implementation of marketing concepts to support its entrepreneurial efforts (Barrett and Weinstein, 1998). A firm's market orientation may be subordinate to the firm's market structure, as how a firm views the market will determine how it communicates its marketing message to potential customers.
Market structures subsume market factors in that market structures include the relationships of the firm and individuals within the firm to other market factors. Individuals act based on their understanding of their environment, and use rules based on experience with the environment to consciously or unconsciously guide their actions (Weick, 1995). Historical environments were simple relative to modern environments. Individuals operating in those environments developed reliable rules of action that rarely changed. The modern environment appears much more turbulent (Emery & Trist, 1965) and the wealth of information in today's markets creates a situation where bounded rationality and cognitive abilities matter (Simon, 1978; Meyer and Banks, 1997; Augier, 2001). The use of heuristics or guiding rules may increase procedural efficiency (Simon, 1978. However, these heuristics and guiding rules are dependent on individual market perceptions and how individuals construct these rules may significantly influence decision-making processes and decision outcomes (Aldrich, 2001; Simon, 1992).

Market structures differ from industry structures, such as the Five Forces Model (Porter, 1980). Porter's Five Forces Model addresses the market factors within the identified industry, such as the power of buyers, sellers, and substitutes or the effects of rivalry or new entrants. The Five Forces Model does not address that environmental factors may interact with each other or industry factors, e.g., interest rate changes affecting the rate of technology development or that increased rivalry may support genesis of new substitutes as firms seek more profitable niches.

Market structures are a more complex market conceptualization than market orientation, market factors, or industry structures. Market structures include all market elements at the firm, industry, and macro environmental levels and all of the interaction among these elements as a network constellation that affect how a market operates and how firms generate economic rent.
THE ROLE OF MARKET STRUCTURE.

The Role Of Market Structure In Strategy Thought

Traditional strategic literature views market structure as an exogenous variable, both given and fixed. The resource-based view of strategy (Barney, 1991; Mahoney and Pandian, 1992; Wernerfelt, 1984) focuses on how resources are allocated to firms and how firms’ choose to use those resources. Firm competitiveness is affected by market structure as an exogenous variable because assessments of value, rarity, and barriers to imitation are linked directly or indirectly to market factors (Dierickx & Cool, 1989).

The role of market structure as an explicit albeit exogenous variable has evolved from earlier views that did not explicitly consider market structure to more modern views which allow that market structures define what strategy is appropriate (Hoskisson, Hitt, Wan, and Yiu, 1999). Early views of strategy (i.e., Bain, 1956; Mason, 1939) suggested that strategy was a search for monopoly power. Monopolistic firms can define a significant amount of market structure because they have sufficient power to dictate many market factors and how those factors interrelate. Market structure in the monopolistic conceptualization of strategy is an outcome, not a defining concept, and is not an explicit consideration.

The industry-organization (I-O) economics paradigm evolved from the early focus on monopoly power. I-O economics assumes that firms are more likely to use intra-industry and inter-firm competition than monopoly power (Porter, 1980, 1985). This paradigm holds that market structure and value generation are dictated by market-specific variables, as demonstrated by the Five Forces Model of industry competition (Porter, 1980). However, I-O economics and Porter's Five Forces Model address only the existence of market factors, not that the relationship among these factors may potentially change, e.g., interest rate changes affecting the rate of
technology development. Market structure plays a central albeit static role in I-O economics as a result. The result is that I-O economics and Porter both view market structure as exogenous to the strategic model, i.e., market structure exists and firms cannot change the structure. Selecting the correct industry is critical in I-O economics because selecting an industry also selects that industry's inherent market structure and the resultant ability to generate economic rent (Barney, 1991). However, explicit choice of a market structure is not central to the I-O view of strategy.

Hosskison, et al. (1999) note that transaction cost theory addresses market structure more specifically than other parts of I-O economics. Transaction cost economics focuses on the interface between market and organization structure and where one starts and the other stops (Williamson, 1975). Market structure is critical to transaction cost theory because the relationship among market factors affects contracting, ex ante, and ex post legal protections and plays an important role in defining how each impacts organizational choices (Argyres and Liebeskind, 1999; Williamson, 1985). Agency theory is another offshoot of I-O economics and focuses on internal firm transactions and ignores market structure (Jensen and Meckling, 1976).

The next evolutionary step in strategic-thinking is the resource-based view of strategy (Barney, 1991; Wernerfelt, 1984). The resource-based view suggests that firm competitiveness is affected by how resources are allocated to firms and how firms choose to use those resources. Market structure affects firm competitiveness because assessments of value, rarity, and barriers to imitation are linked directly or indirectly to market factors (Dierickx and Cool, 1989). Firm resource deployment and activities are attempts to control market behavior by managing the stocks and flows entering the market (Ghemawat, 2001). Successful attempts to influence market behavior affect market structure. However, market structure changes are incidental to the resource deployment because firms generally view market structure as given (Ghemawat, 2001).
The Role of Market Structure in Entrepreneurial Thinking

The entrepreneurship literature takes a decidedly different view than the strategy literature in that entrepreneurs are viewed as responsible for the formation and destruction of market structures (Kirschhoff, 1991). Entrepreneurs pull together suppliers, customers, and producers and coordinate activities across these parties (Kirzner, 1979, 1982; Lackman, 1977). Entrepreneurs form and reform market structures based on their strategic insights (Schumpeter, 1934). The entrepreneurial focus is to select or create a market where a given resource set can be used to maximize economic rent (Lackmann, 1997; Hitt & Ireland, 2002). Entrepreneurs view market structure as a variable of interest that can be manipulated and altered as needed to create rent-generating opportunities (Kirzner, 1982). Market structure is an endogenous and important variable in entrepreneurial thinking as a result.

The entrepreneurship literature suggests more successful entrepreneurs scan the environment frequently and take action immediately (Analoui & Karami, 2002; Vebasaran, Westhead, & Wright, 2001). One possible outcome of this scanning and taking action is creative destruction of previous market structures (Schumpeter, 1934). Creative destruction is the dissolution of existing market structure and creation of a new market structure with new or differently-organized market relationships and factors. The entrepreneurial school of thought holds that determining market structure is a conscious entrepreneurial choice.

However, Brazael and Herbert argue that the role of the entrepreneur has not been well explicated, especially when addressing issues such as market structures. Specifically, they noted that "The unique mentality and accompanying philosophy of the entrepreneur has not been fully explained in a practical context, particularly with reference to perceptual issues surrounding the seizing of opportunities" (1999:42).
Summary

The above discussion suggests that strategic thinking treats market structure as either an exogenous or relatively stable variable. Direct manipulation of market structure is not discussed in the strategic literature. Direct manipulation including the creation and destruction of market structure is a central theme of the entrepreneurial literature. However, the entrepreneurial literature does not offer explanations of how this destruction/creation is done.

A MARKET-BASED VIEW OF ENTREPRENEURSHIP

The above discussion suggests that the manipulation of market structures can play a central role in explaining the entrepreneurial process. Specifically, the entrepreneur can be viewed as searching for new market structures that meet his or her needs, even if the resources needed to create the requisite market structure is not within the entrepreneur’s current control (Sahlman, Stevenson, Roberts, and Bhide, 1999). The key for the entrepreneur is not control of market assets as much as it is the ability to specify what factors constitute the market structure and the relationships among these factors.

The critical activity of the entrepreneur in this view is to construct the appropriate market structures through reification (Weick, 1979, 1995) and then to generate support and to gain acceptance across the market structure for this reification. This section explores the process of reification as it applies to the creation and acceptance of market structures and the relationship of these concepts to a market-based view of entrepreneurship.
The role of the entrepreneur in reifying new markets

Reification is the process of regarding something abstract as if it is a material thing (American Heritage Dictionary, 2002). Individuals often treat abstractions as if the abstractions are real as part of socially constructing systems of understanding (Berger and Luckmann, 1966). Individuals treat socially-constructed reifications as real entities (Weick, 1995).

Organizations, markets, and industries are reifications and do not exist as entities in real space (Dutton and Dukerich, 1991; Lukacs, 1971; Weick, 1979, 1995). The reification process begins when a set of assets, firms, or market entities is labeled as an entity as a heuristic reference (Cyert & March, 1963). Acceptance of the heuristic by an industry, society, or culture leads to the heuristic becoming an accepted social construction and society begins to treat the reification as if it were real. The reification of organizational assets as corporations that exist as legal fictions that are “an artificial being” is an accepted element of U.S. common law (Schneeman, 1997:159).

Maintaining a reification may be impossible if the market factors and market structures both change dramatically. The resulting market destruction, which includes rejection of the associated market structure, is radical by definition (Black and Sherman, 2004). Market destruction results in a turbulent environment where "the very ground is in motion" (Emery and Trist, 1965:23). Market destruction may be perceived as near chaotic or chaotic states described in complexity models (Anderson, 1995; Stacey, 1995).

An important paradox that occurs at the point of market destruction is that the need for sense-making is heightened at the same time sense-making becomes more difficult as both market factors and market factor relationships dramatically change and the existing reification of market structures becomes less viable. Market participants enter a stage of "vu jâdê", loosely
translated as "I have never been here before" (Weick, 1993:633). Market participants then struggle to find environmental cues to generate sense-making schemas (Weick, 1993).

An example of market destruction is the 1984 court-ordered breakup of AT&T into the Regional Bell Operating Companies (RBOCs). AT&T's monopoly power in the pre-existing market dominated market relationships and was eliminated by the breakup. The number of competitors in the market rose as the monolithic AT&T was replaced with separate RBOCs and new telecommunications competitors, i.e., Sprint, MCI. The role of existing market factors and the increased number of market factors created new, and dramatically different, market factor relationships. The result was market destruction and the replacement of the pre-existing market structures (Ma Bell rules) with a new market structures (competition).

Reifications of market structures include generation of other cultural and psychological phenomenon, including dominant logic and macrocultures (Abrahamson and Fombrun, 1994; Prahalad and Bettis, 1986). The failure of market structures may mean the dominant logics fail or the macrocultures are no longer viable, or adapt to meet the new reifications’ needs. Also, individual munificent firms may ride out brief turbulent periods by addressing the higher levels of ambiguity with additional buffering or resource reserves to deal with the increased uncertainty (Milliken, 1988; Pfeffer and Salancik, 1978). However, the ability to rely on such buffering or slack resources for longer time frames is limited.

Entrepreneurs may happen onto market destruction after the market has failed. The entrepreneur may be able to reify a new market structure that serves the entrepreneur in reaction to the market destruction. However, this scenario assumes that others will not have taken advantage of the market destruction before it is a fait accompli and that the entrepreneur will be able to institute a market reification that meets the entrepreneur’s needs before others act.
Entrepreneurship as proactive reification

An alternate view is that an entrepreneur may proactively create market structure changes that promote market destruction. Entrepreneurs may view the current reification of market structure as not meeting the entrepreneur’s needs (Sahlman, et al., 1999). The entrepreneur then can enact changes to market structure by developing strategies that force changes in market factors, market factor relationships, and/or how a market views itself or its stakeholders. These shifts can be accomplished by manipulating market timing, disintermediation of market factors, introduction of new market mechanisms, and including or excluding previous market factors. The success of entrepreneurial action centers on the ability of the entrepreneur to successfully guide reification of market structures. A key to successful entrepreneurial action becomes the ability to guide market perceptions that may be influenced by bounded rationality, allegiance to prior dominant paradigms, self-interest, and other individual or organizational biases and schemas (March and Simon, 1958; Williamson, 1985; Weick, 1979). The successful entrepreneur develops reifications that integrate strategic, environmental, and internal elements into an effective entrepreneurial orientation to address market needs (Covin and Slevin, 1991).

This view suggests that entrepreneurial behavior centers on entrepreneurial reification of market structures that support the entrepreneur’s products or services (Gartner, 1994). The entrepreneur’s focus is on reifying the right set of market factors and relationships among factors and then promote the requisite social construction for widespread acceptance of the reification as the current market structure. Entrepreneurial behavior is dependent on the ability to identify and reify the appropriate market and is market-based, similar to the concept that business strategy can be viewed as resource-based (Barney, 1991). The market-based entrepreneur is dedicated to resolving the problem of creating market structures that match the entrepreneur’s needs by
reifying which market factors and which relationships among those market factors are important. This parallels that the resource-based strategist is dedicated to resolving the problem of how to leverage firm resources given a firm’s external environment (Barney, 1991).

The market-based view of entrepreneurship can be viewed as an extension of earlier work by Schumpeter (1934), Covin and Slevin (1991), Gartner (1992), and Sahlman, et al. (1999). Schumpeter noted that entrepreneurship activity occurs when the entrepreneur actively envisions and “carries out new combinations” as a means toward creative destruction (1934:78). Similarly, Gartner differentiates entrepreneurs from traditional managers in that entrepreneurs work within emerging frameworks, managers operate within frameworks made more stable by time, and the entrepreneur’s work is complete once an organization is created (Gartner, 1994). Sahlman, et al. (1994) buttress this by suggesting that entrepreneurial behavior focuses on identifying market opportunities, more than firm strengths. Schumpeter, Covin and Slevin, Gartner, and Sahlman, et al echo a common theme that entrepreneurs combine new resources within emerging contexts replete with contexts – the same behavior this paper describes as reifying market structure.

The Strategist In Contrast To The Entrepreneur

The above discussion also illustrates the critical differences between a strategist and a entrepreneur. The strategist approaches the issue of generation of economic rent from a resource perspective – what resources does the firm control – versus the entrepreneur approaching rent generation from the question of how can the necessary market be created. This differentiation parallels the differentiation between promoter and trustee offered by Sahlman, et al (1994). The net effect of the two approaches is that the strategists work is a long-term engagement centering on matching controlled resources with existing and given markets, and the entrepreneurs is a
shorter-term engagement that centers on the reification of the necessary market structures that provide the entrepreneur with the opportunity to generate economic rent. The strategist is matching resources to markets while the entrepreneur is creating markets and hoping to take advantage of those markets once created. The strategist’s thinking and action are resource-based, and the entrepreneur’s thinking and action are market-based.

DISCUSSION

Back to Impact

The story of Impact, Texas is an example of proactive reification and the market-based view of entrepreneurship. West Texas market structures before the incorporation of Impact simply did not provide for liquor stores. The political-legal and socio-cultural systems prohibited legal operation of liquor stores and the threat of entry into the retail commerce industry was non-existent because of government regulations aligned with the areas conservative religious beliefs (Milliken, 1988; Porter, 1980; Whitaker, 2002). Perkins reified a new market structure by incorporating his poultry farm and the nearby acreage into the town of Impact that could then vote for local option liquor sales. The new reification was intended to fit Perkins’ environment with his resources to create an opportunity to generate economic rent (Penrose, 1957). Perkins’ reification engendered market destruction of the old market where liquor sales were prohibited by engineering the creation of a new market where liquor sales were permitted, at least within the confines of the city of Impact, Texas. The result was that the old reification of market structure – where liquor sales were illegal and the production and sales of moonshine was a necessary albeit illegal byproduct – was replaced by a new reification of market structure.
The story of Impact, Texas also illustrates other issues faced by entrepreneurs as they reify market structures. One issue is that those vested in the old market structures will defend the existing paradigm attached to those structures. The twenty citizens of Impact voted for local option liquor sales in 1960. An odd alliance of conservative religious groups funded by moonshine producers fought Impact’s incorporation and local option election and delayed the opening of liquor stores in Impact until 1962 (Haymes, 1995; Whitaker, 2001). Another example of legal action being used to delay new market structure reifications taking hold is Southwest Airlines’ 1969-1971 court fight to operate outside of the U.S. Civil Aeronautics Board (CAB) regulations (Petzinger, 1995). American, Braniff, and other competing carriers mounted court challenge to prevent Southwest Airlines from enacting its reification of an industry independent of CAB control (Freiberg and Freiberg, 1996).

The efforts of firms vested in the existing market structures to protect those market structures is an example of resource dependency (Pfeffer and Salancik, 1978). The need to protect and defend a munificent environment is natural and logical (Milliken, 1988). The inability of those vested in the existing dominant logic to understand the viability of the new market structures and the resulting dominant logic may also be a form of paradigm blindness that prevents them from even basic recognition of the new paradigm (Kuhn, 1970).

However, the tension between those defending the existing market structures and those attempting to institute new market structures is also increased because entrepreneurs may also suffer from paradigm blindness that prevents the entrepreneur from recognizing the importance of the old market structures to those vested in those structures and associated paradigms. This entrepreneurial paradigm blindness made it difficult for those supporting local option liquor sales to understand the opposition they faced because they were unable to comprehend that the
conservative religious groups that opposed local option liquor sales did so because drinking alcohol was antithetical to their belief system.

Another issue facing those reifying new market structures is that the entrepreneur does not have control over the new market structure once the reification becomes socially accepted. Liquor sales at Impact thrived until the populace of nearby Abilene accepted the reification that liquor sales were okay and voted for local option liquor sales in Abilene in 1978 (Whittaker, 2001). Southwest Airlines was able to survive and thrive in the post-deregulation environment and California’s Pacific Southwest Airlines – which was the first airline to operate outside CAB control – did not survive market pressures created by its entrepreneurial action (Petzinger, 1995).

This phenomenon is the Frankenstein effect. Dr. Frankenstein was destroyed by the monster he created as the result of the monster’s interaction with the environment and resulting evolution. Entrepreneurs often create new market structures that overwhelm the entrepreneurial progenitor because the market structures interact with the environment and these interactions create evolutionary pressures on the market structure reifications. Apple Inc.’s 1979 introduction of the personal computer created the personal computer industry as an entirely new market structure. The personal computer market evolved and changed with the introduction of the IBM PC in 1981, the proliferation of clones, and the introduction of Windows until Apple was almost overwhelmed by the industry it created in 1997 (Yoffie, 2004).

The lesson presented to entrepreneurs by the issues of their own paradigm blindness and the Frankenstein effect is that market creation is a continuing process and, like so many other dynamic issues, every sword has two edges. It is the paradigm blindness of others and the resulting inability to move outside of the existing market structures that creates entrepreneurial opportunity for market anomalies or market destruction. Failing to understand the causes of
paradigm blindness may prevent understanding existing competitors’ guiding paradigms and lay the ground work for the entrepreneurs own destruction as the market structures they reified evolve through the process of social construction. The market-based entrepreneurial view is equally dependent on market structures evolving as a product of social construction as it is on the entrepreneur reifying new market structures.

SUMMARY AND CONCLUSIONS

Summary

This paper has proposed a market-based view of entrepreneurship based on the ability of entrepreneurs to reify new market structures and change the existing market structures within a market or industry. The paper also examined how the market-based view of entrepreneurship extends earlier conceptualizations of entrepreneurship offered by Schumpeter, Covin and Slevin, Gartner, and Sahlman and colleagues and offers an initial examination of issues facing the entrepreneur reifying new market structures.

Conclusions

The market-based view of entrepreneurship provides a starting point to build a richer definition of entrepreneurship and the entrepreneurial process. Gartner (1994) both promoted the search for a better definition and questioned whether a broadly accepted conceptualization of what an entrepreneur was and what he or she did was possible. This paper offers one idea as part of the larger conversation.

Potential future research
This discussion in this paper lays the groundwork for empirical study of the entrepreneurial reification process. This paper also illustrated the power of qualitative storytelling to provide insight into the entrepreneurial process. Further qualitative efforts to capture the richness of the entrepreneurs’ stories needs to be encouraged and also complemented by quantitative research into nature of market structures as networks.

*Potential practitioner applications*

This paper offers entrepreneurial practitioners a model that may be useful for self-reflection. Some believe that entrepreneurial tendency is an innate resource and can not be taught (Gartner, 1994). This paper suggests that entrepreneurial reification of market structures is a process that can be explicated and, therefore, learned. Another application for the entrepreneurial practitioner is the knowledge that the entrepreneurial process of market structure reification promotes comprehending the limitations created by entrepreneurial paradigm blindness and the Frankenstein effect. Comprehension of these limitations may promote better control of their effects.
References


