

Humboldt-Universität zu Berlin

DIPLOMARBEIT

**Austrian Economics as a Basis for a
General Marketing Theory: Potentials
and Limitations**

Zur Erlangung des Grades eines Diplom-Kaufmanns

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Abstract

In the field of marketing a number of theories compete for recognition, academic support and theoretical credibility. There are e.g. approaches from such diverse fields as economics, psychology and sociology. All in all, research on marketing is highly fragmented. The work at hand is a study on possibilities and obstacles of promoting “Austrian economics” – which emphasises the coordinating role of information (mostly via price-signals) in dynamic markets – as a general marketing-theory.

At first, this thesis describes different concepts and problems toward marketing and marketing-theory. Then, epistemological principles and criteria towards marketing theories are discussed and the properties of Austrian economics in regard to marketing are shown. In the second half the epistemological criteria are applied on Austrian economics.

In a Popperian framework Austrian economics suffers from certain weaknesses. Its immunization tendencies are an obstacle to empirical testing of its assumptions. However, Austrian economics offers important insights: Especially the descriptive and explicative properties of Austrian economics that are fruitful for marketing-theory. Without marketing, the market process would come to a halt in a state of disequilibrium. It is the informational role of marketing that improves the choices of alert consumers.

Keywords: Marketing-theory, Austrian economics, marketing, market process

Abstract

Im Marketing konkurrieren eine Reihe von Theorien um Aufmerksamkeit, Unterstützung durch akademische Forschung und theoretische Glaubwürdigkeit. Es gibt z.B. Ansätze aus so unterschiedlichen Bereichen wie der Volkswirtschaftslehre, Psychologie und Soziologie. Alles in allem ist die Marketing-Forschung stark zersplittert. Die vorliegende Arbeit behandelt die Möglichkeiten und Grenzen der Marktprozessstheorie (Österreichische Schule der Nationalökonomie) – eine Theorie, die die Rolle der Information (hauptsächlich durch Preissignale) bei der Koordinierung in dynamischen Märkten betont – als allgemeine Marketingtheorie.

Zuerst beschreibt diese Diplomarbeit verschiedene Konzepte und Probleme des Marketings und der Marketingtheorie. Danach werden wissenschaftstheoretische Prinzipien und Kriterien, die an Marketingtheorien gestellt werden, diskutiert. Die für das Marketing relevanten Eigenschaften der Marktprozessstheorie werden vorgestellt. In der zweiten Hälfte der Arbeit wird die Marktprozessstheorie in Bezug auf die dargelegten wissenschaftstheoretischen Kriterien analysiert.

Im Popper'schen Sinn zeigt die Marktprozessstheorie Schwächen. Immunisierungstendenzen verhindern empirische Tests ihrer Annahmen. Trotzdem vermittelt die Marktprozessstheorie wichtige Einsichten: Die Informationsfunktion des Marketings ist für verbesserte Entscheidungen der Konsumenten verantwortlich. Insbesondere die Fähigkeit zu beschreiben und zu erklären macht die Marktprozessstheorie fruchtbar für die Marketingtheorie. Ohne den Einsatz des Marketings würde der Marktprozess in einem Ungleichgewicht zum Stillstand kommen.

Schlagwörter: Marketingtheorie, Marktprozessstheorie, Marketing, Österreichische Schule der Nationalökonomie

Table of Contents

1	Introduction to the Problem _____	1
2	The State of Marketing Theory in Absence of a General Theory _____	3
2.1	The Scope of Marketing and Objectives of Marketing Theory _____	3
2.2	Sources of Marketing Theory _____	6
2.3	Problems of Marketing Theory _____	9
3	Epistemological Principles and Criteria for Marketing Theory _____	10
3.1	Elements of Theory Construction _____	11
3.1.1	Use and Abuse of Assumptions _____	11
3.1.2	Definitions and Terms as a Basis for Good Hypotheses _____	11
3.1.3	Hypotheses and Laws as the Core of Theorizing _____	11
3.1.4	Makeup of Theories and their Status in Science _____	12
3.2	Criteria for a Qualitative Assessment of a Theory _____	13
3.2.1	Universality, Precision, and Empirical Content _____	13
3.2.2	Empirical Content, Logical Scope, and Falsification _____	14
3.2.3	The ‘Triangular Problem’ of Novelty, Truth, and Empirical Content _____	15
3.3	Fields of Application of a Theory _____	16
3.3.1	Description and Explanation of Reality _____	16
3.3.2	Prediction of Future Incidents and Technological Use _____	17
3.3.3	A Theory as a Device for Criticizing Social and Ideological Conditions _____	18
4	Fundamentals of Austrian Economics _____	19
4.1	Assumptions of Austrian Economics _____	19
4.2	The Working of the Market Process _____	22
4.2.1	The Market Process under the Influence of Ignorance _____	23
4.2.2	Entrepreneurship in the Market Process _____	25
4.2.3	Price Rivalry, Non-Price Rivalry, and Monopolistic Competition _____	28
4.3	Hypotheses of Austrian Economics _____	30
5	A Review of Austrian Economics as a Marketing Theory _____	32
5.1	A Qualitative Assessment of Austrian Economics _____	32
5.1.1	An Assessment of the Assumptions of Austrian Economics _____	32
5.1.2	An Assessment of the Hypotheses of Austrian Economics _____	36
5.1.3	The ‘Triangular Problem’ in Austrian Economics _____	42

5.2	Application of Austrian Economics as a Marketing Theory	43
5.2.1	Description and Explanation of Reality	43
5.2.2	Prediction of Incidents and Technological Use	50
5.2.3	Austrian Economics as a Device for Criticism	51
5.3	Implications of Austrian Economics for Influencing Transaction Processes: The Entrepreneur as the Marketing-Manager	53
5.3.1	The Pricing Policy in the Competitive Environment	54
5.3.2	The Product Policy: Adapting to Customer Preferences	55
5.3.3	The Communication Policy: Selling Gas-Which-Is-Known-About	57
5.3.4	The Distribution Strategy in the Market Process	59
6	Conclusions and Summary	60
	References	63
	Appendix	77

List of Abbreviations

AMA	American Marketing Association
c.p.	ceteris paribus
IO	Industrial organization
NIE	New Institutional Economics

List of Figures

Figure 1: The ‘Triangular problem’ of novelty, truth, and empirical content, p. 77.

Figure 2: Differences between explanation and prognosis, p. 77.

Figure 3: Six potential outcomes of the market process, p. 77.

1 Introduction to the Problem

The common perception of marketing is that of an interdisciplinary field comprising knowledge from diverse fields of science, like business administration, sociology and mathematics.¹ Despite – or probably because of this diversity – there have been extensive complaints about a deficit concerning the scientific status and the theoretical foundation of marketing.² Even though Meffert’s call for a general marketing theory has only been one in a long row starting in the 1940s,³ marketing is still in a state of unresolved coexistence of theories, and in danger that the different schools of thought ignore each other.⁴ In this state of affairs the introduction of a general marketing theory is not only an academic “red herring” and a matter of “status seeking” that has the sole purpose of underpinning the scientific status of marketing.⁵ Sheth, Gardner and Garrett offer three reasons why a general marketing theory is advantageous: first it could serve as a reference point for the fragmented scientific community. Theorists pursuing a limited theory in a narrow area would be encouraged to relate their findings to the general theory. Second, a general theory would help to overcome the identity crisis of marketing. Third, a general theory built on sound foundations would strengthen the credibility of marketing science with practitioners.⁶ Rese calls for a microeconomic theory of marketing, a theory that would refer to individual actions employing assumptions that basically reflect the characteristics of market actors. Meffert’s rediscovery of the economic core in current marketing theory is encouraging, as well.⁷ Austrian economics could be the foundation for the development of a comprehensive marketing theory.⁸ Adopting and refining this microeconomic theory for marketing is contrary to Bartels, who suggests integrating seven sub-theories into a genuine general theory of marketing.⁹ A genuine general marketing theory has not yet been developed, so the adoption of Austrian economics could be worthwhile. Among others, Backhaus sees a close resemblance between Austrian economics and

¹ Cf. Chmielewicz (1988), p. 450.

² Cf. Rese (2000), p. 214; critically e.g. Schneider (1983a) and (1983b); attacking Schneider cf. Dichtl (1983); favourably e.g. Leong (1985), p. 32.

³ Meffert (2000), pp. 333f.

⁴ Cf. Kaas (2000), p. 73.

⁵ Cf. Buzzell (1963), p. 36.

⁶ Cf. Sheth/Gardner/Garrett (1988), p. 18; El-Ansary (1979), p. 399.

⁷ Meffert (2000), pp. 333f.

⁸ Cf. Rese (2000), pp. 214-216.

⁹ Cf. Bartels (1968), p. 32.

many issues of marketing.¹⁰ Schneider condemns both behaviourism and equilibrium thinking in marketing. Instead, he also suggests building the theoretical foundations of marketing on market processes, the role of entrepreneurs in competition and the informational role of markets.¹¹ Since marketing is a dynamic process, any marketing theory should account for this fact, even though most existing marketing concepts are more or less static.¹² Austrian economics can be this alternative to static theories: “[...] [C]ompetition is presented as a dynamic process, driven by alert entrepreneurs who creatively seek and use their market chances [...]”.¹³ Austrianism goes well beyond price theory and refers to product policy, advertising, and sales-efforts, too.¹⁴ Additionally, it is not only possible to trace the origins of marketing back to the ‘Austrian school of economics’ at the end of the 19th and the beginning of the 20th century, but also to see important impacts on the ideas of marketing thinkers like Alderson and economists as in Porter’s concept of generic strategies for achieving competitive advantage.¹⁵ But despite its long history, thinking in market processes could not yet leave its outsider-status in business- and marketing science yet.¹⁶ Under these premises, an attempt to evaluate Austrian economics as a high-level explanation of marketing seems to be inevitable. It is claimed that “[t]he Austrian takes a position midway between that of the behaviourist and [...] neoclassicism”.¹⁷ The analysis put forward analyses if this middle position of Austrian economics, in regard to research about Austrian economics in marketing,¹⁸ holds integrative, descriptive and prescriptive, and generally explanatory powers for marketing theory.

The work on hand is structured as follows: The subsequent chapter two is an overview of the current state of marketing theory. The purposes, sources and problems of marketing and marketing theory are laid out, as well as reasons why a general marketing theory is both necessary and useful. Chapter three sets the epistemological foundations for the analysis. It puts forward basics from the philosophy of science. The qualities of Austrian economics will be later evaluated in regard to these epistemo-

¹⁰ Cf. Backhaus (2000), pp. 4f.

¹¹ Cf. Schneider (1983a), p. 198.

¹² Cf. Sheth/Gardner/Garrett (1988), p. 194; Mattmüller/Tunder (1999), p. 443.

¹³ Fritz (1990), p. 496; [„[...] Wettbewerb als ein dynamischer Prozess, der von wachsamem Unternehmen in Gang gehalten wird, die kreativ ihre Marktchancen suchen und nutzen [...]“].

¹⁴ Cf. Fritz (1990), pp. 496f.; cf. e.g. Kirzner (1973), chapter 4, pp. 135-186.

¹⁵ Cf. Kleinaltenkamp/Jacob (2002), p. 149; Alderson (1957); Porter (1985).

¹⁶ Cf. Schneider (1983a), p. 216.

¹⁷ Block (1999), p. 24.

¹⁸ Cf. e.g. Kirkpatrick (1983); Block/Barnett II/Wood (2002); Meyer (1997).

logical foundations. Chapter four describes the fundamental assumptions and the working of the market process in Austrian economics. Chapter five contains the main analysis. The epistemological criteria of Austrian economics are critically evaluated, its applicability as a marketing theory, and the potential of deriving implications for marketing from Austrianism. Finally, conclusions and a summary are put forward in chapter six.

2 The State of Marketing Theory in Absence of a General Theory

2.1 The Scope of Marketing and Objectives of Marketing Theory

Despite long-lasting discussions about the content of marketing, its core is still controversial.¹⁹ One definition claims that “[m]arketing means [...] planning, coordination and control of all activities towards current and potential markets. The goals of the company are to be reached through constant satisfaction of customer needs [...]”.²⁰ The American Marketing Association (AMA) defines marketing as “[...] the process of planning and executing the conception, pricing, promotion and distribution of ideas, goods and services to create exchanges that satisfy individual and organizational objectives”.²¹ Still another definition claims that “[m]arketing is a social and managerial process by which individuals and groups obtain what they need and want through creating, offering and exchanging products of value with others”.²² Marketing need not be ashamed of this diversity of definitions since the much older discipline of philosophy has not even developed consensus on a commonly accepted definition.²³ Traditionally, the term ‘marketing’ refers to acts of buying and selling in a market.²⁴ This is also the underlying rationale of all the former statements: that two or more parties engage in an exchange of resources.²⁵ Transactions occur only if the force of marketing brings the producers and consumers who are parties to a potential

¹⁹ Cf. Backhaus (2003), p. 6.

²⁰ Meffert (1998), p. 7; [„Marketing bedeutet [...] Planung, Koordination und Kontrolle aller auf die aktuellen und potentiellen Märkte ausgerichteten Unternehmensaktivitäten. Durch eine dauerhafte Befriedigung der Kundenbedürfnisse sollen die Unternehmensziele [...] verwirklicht werden“].

²¹ Brown (1985), p. 1.

²² Kotler/Bliemel (1999), p. 8; [“Marketing ist ein Prozess im Wirtschafts- und Sozialgefüge, durch den Einzelpersonen und Gruppen ihre Bedürfnisse und Wünsche befriedigen, indem sie Produkte und andere Dinge von Wert erzeugen, anbieten und miteinander austauschen“].

²³ Cf. Hunt (1976), p. 24.

²⁴ Cf. Dixon (2002), p. 88.

²⁵ Cf. Engelhardt (1998), pp. 11f.

exchange, which were only in a loose relationship before, into contact.²⁶ Then it can be said that the essence of marketing relates to the structuring and organizing of the exchange,²⁷ e.g. through manipulation of the marketing mix variables, the so-called '4 P's' product, price, place (distribution), and promotion.²⁸ A newer extension of marketing puts an emphasis on relationships, in which the creation of customer satisfaction is the first step to create loyalty, since it is often easier and cheaper to keep existing customers than to find new ones. The former policy is more profitable, as well.²⁹ Exchanges are not static, but processes subject to the dimension of time. The exchange itself is only the culmination of activities that are directed towards it.³⁰ The execution of an exchange transaction depends on the parties involved, especially their agreement on the terms of trade. Exchanges will only take place if they enhance (or at least do not deteriorate) the situation *ex ante*.³¹ When in the 1960s demand became the bottleneck of businesses, companies needed to focus on customer demands.³² Marketing became responsible for finding and satisfying potential and actual desires of consumers.³³ Goods or services that solve customer-problems have to be offered.³⁴ The marketing-driven company will only succeed and engage in an exchange with a consumer if the offer it makes is better than the offers made by all relevant competitors.³⁵

A science like business administration and its subfield marketing are not confined to description, but open to find explanations, prognoses and decision rules to enhance our lives.³⁶ In order to do that, a theoretical background is of principle necessity.³⁷ The AMA formally recognized the need for marketing theory for the first time in 1946.³⁸ In the 1970s Ryans, Van't Spijker and Bergin conducted an empirical study on the need for a theoretical background of marketing and found extensive support among marketing academicians and practitioners. Out of their sample 90 per cent agreed that the quest for theory in marketing is a worthwhile objective. Furthermore,

²⁶ Cf. McInnes (1964), pp. 56f.

²⁷ Cf. Arndt (1983), p. 44.

²⁸ Cf. Kotler (1972), p. 52.

²⁹ Cf. Meffert (1999), p. 41; Kotler/Bliemel (1999), S. 71; Anderson/Sullivan (1993).

³⁰ Cf. Plinke (2000a), p. 15.

³¹ Cf. Kotler/Bliemel (1999), p. 12.

³² Cf. Keith (1960), p. 35.

³³ Cf. Keith (1960), p. 37; Levitt (1960), p. 50.

³⁴ Cf. Alderson (1957), p. 164; Plinke (2000b), p. 127.

³⁵ Cf. Plinke (1992), pp. 835f.

³⁶ Cf. Kaas (2000), p. 57.

³⁷ Cf. Raffée (1984), p. 13.

³⁸ Cf. Bartels (1970), p. 18.

72.5 per cent of their sample of marketing leaders agreed that the pursuit of a general marketing theory would be a good idea.³⁹ Theory roughly means systematic explanation; it is “a structure that describes the workings and interrelations of the various aspects of some phenomenon”.⁴⁰ It is widely accepted⁴¹ that marketing theory should describe and explain two phenomena:

- (1) Why do people and organizations engage in exchange relations?
- (2) How are exchanges created, resolved, or avoided?⁴²

The basic explananda of marketing theory can be derived out of these questions:

- (1) The behaviour of buyers directed at accomplishing exchanges.
- (2) The behaviour of sellers directed at accomplishing exchanges.
- (3) The institutional framework directed at accomplishing and/or facilitating exchanges.
- (4) Consequences for society of the behaviour of the buyer, seller, and the institutional framework directed at accomplishing and/or facilitating exchanges.⁴³

The capability to develop solutions to the problem of shaping well-founded exchange relationships has been called the ‘core competency’ of marketing theory.⁴⁴ This core competency is not necessarily confined to commercial exchanges or exchanges of consumer goods. The scope of marketing is defined rather broadly, and current marketing theory is applied to exchange relations in intermediate goods and resource markets as well. Marketing theory can also be about the marketing of non-profit organizations and social marketing, or the exchange within organizations.⁴⁵ Wilkinson and Young see the existence of a substantial and evolving body of work on marketing theory and methodology that evolved during the last two millennia, but they admit that the big picture of marketing theory is often not apparent because of a narrow, technique-oriented, normative, micromarketing orientation in average marketing texts.⁴⁶

³⁹ Cf. Ryans Jr./Van’t Spijker/Bergin (1974), pp. 622f.

⁴⁰ Cf. Baumol (1957), p. 414; see section 3 (pp. 10-18) for further details.

⁴¹ Cf. Easton (2002), p. 105; Hunt (1983), p. 9; Arndt (1983), p. 44.

⁴² Bagozzi (1975), p. 32.

⁴³ Cf. Hunt (1983), p. 13.

⁴⁴ Cf. Hansen/Bode (2000), p. 319.

⁴⁵ Cf. Raffée (1995), col. 1669-1671.

⁴⁶ Cf. Wilkinson/Young (2002), p. 82.

2.2 Sources of Marketing Theory

Dixon finds an ancient Greek claim for the invention of permanent marketplaces to facilitate exchange in the writings of the historian Herodotus from the 5th century BC. Exchange transactions always raised questions, e.g. about the sharing of benefits. Philosophers like Plato and Aristotle were dealing with such questions as early as the 4th century BC.⁴⁷ It is presumptuous to call these philosophers the first marketing theoreticians, but systematized ideas about marketing are older than one might think. In 1831 the British archbishop and scholar Whately already suggested that in economic science attention should be focused on human exchange behaviour or ‘catallactics’.⁴⁸ The hour of the birth of modern marketing is nonetheless controversial. Some believe it was in 1960, when McCarthy named the 4 P’s for the first time, while especially in Germany the year 1955 is suggested, when Gutenberg published his ‘Instruments of Sales-Policy’.⁴⁹ German marketing research in the last three decades of the bygone century can be characterized by a large number of theoretical foundations and a variety of research directions.⁵⁰ It goes without saying that this is true for international marketing research as well. It is not surprising since the common perception of marketing is interdisciplinary, comprising knowledge from such diverse scientific fields as business administration, sociology and mathematics,⁵¹ as well as economics, psychology, statistics and operations research.⁵² Altogether, Meffert distinguishes eight important approaches to marketing research (decision orientation, system orientation, behaviourism, the situational approach, New Institutional Economics (NIE), relationship marketing, the resource-based view, and process orientation),⁵³ none of which has a monopoly on marketing theorizing. The three approaches that have reached the status of important paradigms for marketing as identified by Kaas will be briefly introduced. All three of them contain specific strengths and weaknesses: the neo-behaviouristic, the neo-institutional (based on NIE), and the neoclassical approach.⁵⁴ The latter two have been drawn from microeconomic theory. They are simi-

⁴⁷ Cf. Dixon (2002), pp. 88f.

⁴⁸ Cf. Whately (1831), p. 253.

⁴⁹ Cf. Müller-Hagedorn (2000), p. 29; McCarthy (1960); Gutenberg (1955); [“Absatzpolitisches Instrumentarium“].

⁵⁰ Cf. Kaas (2000), p. 72; Backhaus (2000), p. 5.

⁵¹ Cf. Chmielewicz (1988), p. 450.

⁵² Cf. Horsky/Sen (1980), p. S5.

⁵³ Cf. Meffert (1999).

⁵⁴ Cf. Kaas (2000), p. 72.

lar to Austrian economics in that they analyze the decisions of single companies, households or market participants.⁵⁵

Contemporary social sciences are still dominated by the microeconomic paradigm.⁵⁶ Its success in marketing began in the early twentieth century, after many marketing scholars turned to the neoclassical approach of economists such as Alfred Marshall.⁵⁷ Since “[...] marketers and economists are often interested in similar problems”, neoclassicism became important for marketing.⁵⁸ Popular themes in marketing often correspond with a field of research in economics, e.g. advertising, pricing or distribution.⁵⁹ Neoclassicism simplifies reality by assuming that individuals are perfectly informed and try to maximize given goals.⁶⁰ These stringent assumptions allow the construction of abstract, mathematically testable models.⁶¹ The strength of neoclassicism is the analysis and explanation of pricing decisions, the influence of prices on buying decisions and reactions towards changes in price,⁶² but the highly explanatory power of neoclassicism is only reached when the behaviour of the actors is compatible with the assumptions; e.g. as an approximation of the (marketing-) behaviour of companies in industrial markets.⁶³ Marketing is indebted to neoclassicism for important insights, such as the price theory, market reaction functions, and game theory.

One of the latest approaches that is important is the neo-institutional one. Marketing intensively picked up neo-institutional theories in the early 1990s,⁶⁴ at first for marketing in industrial markets, later for services and consumer goods markets as well.⁶⁵ “A central construct [of NIE] is market uncertainty and the way this is dealt with. [...] Exogenous uncertainty is caused by factors not controlled by the relevant actors, while endogenous uncertainty [information asymmetries, expectation of opportunistic

⁵⁵ Cf. Kaas (2000), p. 60.

⁵⁶ Cf. Arndt (1983), p. 46.

⁵⁷ Cf. Sheth/Gross (1988), p. 10. One of the first scholars in early marketing to adopt Marshall’s ideas was Frank W. Taussig, an economist at Harvard Business School who studied in 1879 and 1880 at the Friedrich-Wilhelms-Universität in Berlin, [today Humboldt University (HUB)]. He was also a friend of Ignaz Jastrow, the first rector of the Handelshochschule Berlin, nowadays the Faculty of Economics and Business Administration of the HUB. Cf. Jones/ Monieson (1990), pp. 106f.

⁵⁸ Horsky/Sen (1980), p. S5.

⁵⁹ Cf. Horsky/Sen (1980), p. S6.

⁶⁰ Cf. Arndt (1983), p. 46.

⁶¹ Cf. Terberger (1994), pp. 84f.

⁶² Cf. Kaas (2000), pp. 65f.

⁶³ Cf. Franke (2002), p. 191.

⁶⁴ Cf. Kaas (2000), pp. 62f.

⁶⁵ Cf. Meffert (1999), p. 51.

behaviour] is the result of strategic action of one or more of the exchange partners”.⁶⁶ NIE is based on four components: property rights theory, transaction cost economics, agency theory and information economics. Since these sub-theories focus on uncertainty and the various types of institutions that arise to overcome uncertainty, marketing becomes the management of information and uncertainty in markets.⁶⁷ An example of marketing research based on NIE is the agency-theory explanation of salesforce compensation.⁶⁸

“Since the 1960s, it is rather the so called behavioural sciences which are the major source of marketing theory [...]”.⁶⁹ The basis of behavioural science is knowledge about motives, attitudes, and behavioural patterns of the consumer.⁷⁰ Consumer research in marketing draws heavily on theories and methods from psychology, sociology, social psychology, and behavioural biology, mostly based on neo-behaviourism. Neo-behaviourism sees consumer behaviour towards a product or service offer as the reaction to a stimulus that is moderated through intervening variables and processes (like information processing and attitudes).⁷¹ A large number of theories has been deducted or adopted from the above-mentioned sciences, e.g. the attitudinal theory, the theory of reference prices or attribution theories.⁷² The strength of the neo-behavioural approach towards marketing theory is its power to describe various social and psychological phenomena of consumer behaviour ignored by neoclassical theory, like the impact of advertising, product evaluation and the subjective perception of objective prices.⁷³ In the Anglo-American sphere, consumer researchers drawing on neo-behaviourism are widely accepted and see themselves as the most important school in marketing.⁷⁴

The three paradigms just described were not originally created as marketing theories, but the adoption of relevant parts of ‘foreign’ theories to explain phenomena in marketing is a common and important source of theoretical knowledge in marketing.⁷⁵

⁶⁶ Kleinaltenkamp/Jacob (2002), p. 151.

⁶⁷ Cf. Kleinaltenkamp/Jacob (2002), p. 150-152.

⁶⁸ Cf. Eisenhardt (1988); Ghosh/John (2000).

⁶⁹ Franke (2002), p. 191; [„Seit etwa den 60er Jahren sind die Hauptquelle für Theorien im Marketing jedoch eher die sogenannten *Verhaltenswissenschaften* [...]“]. Italics in original.

⁷⁰ Cf. Meffert (1999), p. 47.

⁷¹ Cf. Kroeber-Riel/Weinberg (1999), pp. 29-31.

⁷² Cf. Franke (2002), p. 191.

⁷³ Cf. Kaas (2000), pp. 64-66.

⁷⁴ Cf. Gröppel-Klein/Weinberg (2000), p. 81.

⁷⁵ Cf. Franke (2002), p. 189.

The second source of theoretical knowledge in marketing research is the development of genuine hypotheses and theories via induction from observations of reality. An example is the ‘product diffusion model of the demand growth for new products’, also called the Bass Model.⁷⁶ It states that the demand for innovative technologies, products, and services roughly follows a bell-shaped diffusion curve.⁷⁷ Demand grows over time because the information about the improved qualities needs time to diffuse across the population of potential buyers,⁷⁸ and declines again after the diffusion of the information about improved technologies.

2.3 Problems of Marketing Theory

Marketing science seems to be torn between feelings of superiority and inferiority.⁷⁹ On the one hand the object of marketing science – marketing – claims to be the essential function of business, existing for the sake of companies, consumers, and the whole society,⁸⁰ and introductions to marketing textbooks culminate in the notion of the ubiquity of marketing phenomena: “[...] marketing as universal truth and fundamental principle of human being”.⁸¹ Academic marketing thus theorizes conflicts between marketing and consumers away: the interests of companies and consumers are aligned if the marketing perspective serves as a guide for company policy. In spite of this, there is a growing fear that mass marketing results in least common denominator goods, producing a conformity of style, marginalizing risk taking, and closing down interpretation.⁸² The possibilities of shaping markets with regular marketing-instruments are more and more questioned.⁸³ In 1945 Converse started the discussion about the scientific status and theoretical background of marketing.⁸⁴ This issue has not been finally resolved and still shatters the self-confidence of those working in the field of marketing.⁸⁵ The question is if marketing is, instead of a science, “rather an art or a practice, and as such much more closely resembles engineering, medicine,

⁷⁶ Cf. Franke (2002), p. 192.

⁷⁷ Cf. Bass (1995), pp. G8f.

⁷⁸ Cf. Bass (1993), p. 4.

⁷⁹ Cf. Bubik (1996), p. 17.

⁸⁰ Cf. Hansen/Bode (2000), p. 314; Keith (1960); Levitt (1960).

⁸¹ Hansen/Bode (2000), p. 314; [„[...] Marketing als universelle Wahrheit und Fundamentalprinzip des menschlichen Seins“].

⁸² Cf. Holt (2002), pp. 70f.

⁸³ Cf. Meffert (1999), p. 42; Tucker (1974), p. 30.

⁸⁴ Cf. Converse (1945).

⁸⁵ Cf. Rese (2000), p. 214; Engelhardt (1998), p. 13.

and architecture than it does physics, chemistry, or biology”,⁸⁶ “the viper at the bosom” of, and all in all a “tragedy” for, business administration.⁸⁷ Harsh criticism against the adoption of particular theories has been launched, e.g. Schneider’s attack against the adoption of non-economic behaviourism in marketing, the application of which by marketers must inevitably be amateurish in his opinion,⁸⁸ followed suit by counterattacks.⁸⁹ Dichtl expressed his fear that marketing academicians “[...] pounce themselves enthusiastically on esoteric concepts of economic provenance with promising names (e.g. transaction cost theory, principal agent theory, and property rights theory) [...]. [...] The picture [of marketing theory] is marked by esotericism, epigones, fashions and omissions”.⁹⁰ One problem mentioned here, the willingness of following and creating fashions by paying much attention to particular topics which are later replaced by even newer fads, led to a highly fragmented science and in part extremely specialized scientists. Since theories with considerable depth but a lack of breadth are constructed especially in the United States, little overall scientific progress is measurable.⁹¹ The neoclassic theory in marketing is not left unchallenged either: due to its strict assumptions, especially concerning the unrealistic view of the *homo oeconomicus*, researchers reject it as the basis for a theory of marketing as exchange.⁹²

3 Epistemological Principles and Criteria for Marketing Theory

The search for criteria separating science from non-science dates back to the beginnings of western philosophy.⁹³ A foundation for the epistemological analysis of Austrian economics on principles of the philosophy of science follows.

⁸⁶ Hutchinson (1952), p. 289.

⁸⁷ Schneider (1983a), pp.198; 200.

⁸⁸ Cf. Schneider (1983a); Schneider (1983b).

⁸⁹ Cf. Raffée (1984); Dichtl (1983).

⁹⁰ Dichtl (1998), p. 47; [„[...] stürzt sich stattdessen begeistert auf esoterische Konzepte volkswirtschaftlicher Provenienz mit verheißungsvoll klingenden Namen (z.B. Transaktionskostentheorie, Principal Agent Theory und Property Rights Theory) [...]. [...] Das Bild ist mithin geprägt von Esoterik, Epigonentum, Modeerscheinungen und Versäumnissen“].

⁹¹ Cf. Engelhardt (1998), p. 13; Dichtl (1998), p. 53; Tietz (1993), p. 158; Sheth/Gardner/Garrett (1988), p. 15.

⁹² Cf. Arndt (1983), p. 46.

⁹³ Cf. Laudan (1980).

3.1 Elements of Theory Construction

3.1.1 Use and Abuse of Assumptions

Assumptions can objectively be correct or incorrect and tested for that property. But in contrast to hypotheses no claim about their truth can be made. Their purpose in science is to simplify a complex problem and the analysis of the problem. There are two caveats against the excessive use of assumptions: Firstly, the employment of assumptions necessarily omits important parts of a problem. Secondly, a model which is based on strict assumptions might immunize itself against reality and empirical testing and thus become unfalsifiable (see section 3.2.2, pp. 14f.).⁹⁴

3.1.2 Definitions and Terms as a Basis for Good Hypotheses

The expression for a certain phenomenon, like ‘costs’, is called ‘term’. If there is uncertainty about a term, it needs to be defined,⁹⁵ thus definitions become the bases for terms. A definition consists of two parts: a short ‘definiendum’ (to be defined) is connected to a longer ‘definiens’ (paraphrase of the definiendum).⁹⁶ Definitions in themselves carry neither information nor truth and they are neither right nor wrong;⁹⁷ they are just agreements and conventions.⁹⁸ The purpose of definitions is to shorten and clarify the language as groundwork for broadly understandable theories.⁹⁹ Terms can be evaluated by their precision, consistency and validity. Ambiguously understood terms are often a major setback for empirical studies, if the correct measurement of designated events is especially important.¹⁰⁰

3.1.3 Hypotheses and Laws as the Core of Theorizing

“Scientific hypotheses are suppositions about the structural nature of reality”.¹⁰¹ While they subjectively claim to be true,¹⁰² scientific hypotheses always have a preliminary character and can, in contrast to definitions, thus be proven wrong.¹⁰³ The ‘truth’ of statements has to be distinguished into logically (L-) determined and factu-

⁹⁴ Cf. Chmielewicz (1988), pp. 121f.

⁹⁵ Cf. Schanz (1988), p. 17.

⁹⁶ Cf. Chmielewicz (1988), p. 452; Popper (1992), p. 17.

⁹⁷ Cf. Chmielewicz (1994), p. 49; Balzer (1997), p. 66.

⁹⁸ Cf. Popper (1989), p. XIX.

⁹⁹ Cf. Balzer (1997), pp. 65f.; Popper (1992), pp. 22f., 26f.

¹⁰⁰ Cf. Schanz (1988), pp. 20-22.

¹⁰¹ Schanz (1988), p. 24; [„Realwissenschaftliche Hypothesen sind **Vermutungen** über die strukturelle Beschaffenheit der Realität“]. Emphasis in original; cf. Schneider (2001), pp. 24f.

¹⁰² Cf. Chmielewicz (1994), p. 119.

¹⁰³ Cf. Schanz (1988), pp. 25; 27.

ally (F-) determined statements. The former are proven by logic and mathematics. Important for this study are the F-determined statements. Their truth can only be examined in reality or with empirical means.¹⁰⁴ Usually a hypothesis passes four stages: the first stage can be called speculation; the second is the empirically tested hypothesis, which is only valid for the explanation of a single phenomenon; at the third stage hypotheses are grounded on a connection to existing knowledge that has not yet been tested. Hypotheses at the fourth stage are called reliable. They have proven to be worthwhile in multiple empirical tests. A reliable hypothesis that has a general scope as well is called a law or a statement of invariance.¹⁰⁵ This assumes that nature, society or man follow some constant pattern or regularity.¹⁰⁶ Similar to terms, acceptable laws fulfil some criteria as well. A law should be applicable to more than one class of events (generality), it should be strictly tested (reliability) and belong to a system of laws.¹⁰⁷ Such a system of laws then forms a theory.¹⁰⁸

3.1.4 Makeup of Theories and their Status in Science

A few scientists regard the creation and definition of terms as the goal of science, whereas the majority of scientists refuse this essentialist view, being inclined to test hypotheses and create new theories.¹⁰⁹ Even though “the term ‘theory’ is vague and ambivalent not only in the social realm, but also in the philosophy of science”,¹¹⁰ there are descriptions of the nature of theories. Theories are systems of laws that contain scientific information in an easily understandable manner. Regularly those hypotheses that reached the status of laws form the basis of such a system, and are called axioms there. Axioms in a theory must be consistent, i.e. they may not contradict each other. Furthermore, the single axioms are preferably independent of each other.¹¹¹ “Theories establish a general cause/effect-connection [and] [...] describe

¹⁰⁴ Cf. Chmielewicz (1988), p. 456.

¹⁰⁵ Cf. Schanz (1988), pp. 27f.

¹⁰⁶ Cf. Albert (1964), p. 40.

¹⁰⁷ Cf. Schanz (1988), p. 29.

¹⁰⁸ Cf. Bunge (1967a), p. 381.

¹⁰⁹ Cf. Chmielewicz (1988), p. 452; Müller-Hagedorn (2000), p. 28. Even though Mephistopheles told one of Faust’s students that “Grey, dear friend, is all theory, and green life’s golden tree” [“Grau, teurer Freund, ist alle Theorie, und grün des Lebens goldner Baum”], “There is nothing more useful for practice than theory” [“Nichts nützt der Praxis mehr als die Theorie”]. Goethe (1961), verses 2038-2039, p. 60; Albert (1971), p. 219.

¹¹⁰ Chmielewicz (1994), p. 162; [“Der **Theoriebegriff** ist aber in der Wissenschaftstheorie ebenso wie im Sozialleben vage und mehrdeutig“]. Emphasis in original.

¹¹¹ Cf. Schanz (1988), pp. 24; 29-31; Popper (1989), p. 41.

empirical regularity or invariance in the nature or the social world [...]”.¹¹² A typical statement from a theory would then be the following: Cause x_1 implies the effects y_1 , y_2 and y_3 . Once a theory has been established on grounds of acceptable laws, it should vice versa be possible to suggest and derive new laws and hypotheses from the theory. Examples are Kepler’s and Galilei’s laws that can be derived from Newton’s theory of gravitation.¹¹³

3.2 Criteria for a Qualitative Assessment of a Theory

The distinction between good and useful theories as opposed to worthless assumptions or, more generally, between knowledge on the one hand and magic, superstition, speculation and dreaming on the other, is very important for the philosophy of science.¹¹⁴ The following criteria have been developed to assess the potential of theories or their basic ingredients, i.e. hypotheses. The first two criteria (universality and precision) determine the empirical content of a hypothesis. The empirical content and its converse of logical scope in turn determine the falsifiability of a hypothesis.

3.2.1 Universality, Precision, and Empirical Content

Good hypotheses, laws, and theories should have a universal character respectively reliability across space and time, which means that their empirical (informational) content grows with increasing validity at different places and points in time. What is similarly important is the conditionality that is expressed in the ‘if-then-form’, e.g. condition p is the cause for consequence q or short: if p , then q . If either the if- or then-component is altered, the empirical content of the hypothesis and thus its explanatory power is altered. The universality of a hypothesis depends on the if-component. Increasing content of the if-component decreases the universality of the hypothesis, and vice versa.¹¹⁵ To put it in other words: the more conditions there are in the if-component, the less likely will the then-component be. On the contrary, the fewer conditions are connected to the if-component, the likelier is the occurrence of the then-component. The precision of a hypothesis is determined by an alteration of its then-component. A reduced (increased) content of the then-component implies

¹¹² Chmielewicz (1994), p. 11; [„Theoretische Aussagen konstatieren einen generellen Ursache/Wirkungs-Zusammenhang [und] [...] eine empirische Regelmäßigkeit der Natur- oder Sozialwelt [...]“].

¹¹³ Cf. Chmielewicz (1994), p. 163.

¹¹⁴ Cf. Feyerabend (1965), p. 331.

¹¹⁵ Cf. Schanz (1988), pp. 32f.

lower (higher) precision of the whole expression.¹¹⁶ Put differently: the more possible outcomes the then-component allows, the lower is the hypothesis' explanatory power. If the universality and precision of a hypothesis grow, its empirical content increases, but the more precise and universal a hypothesis claims to be, the bigger is the number of potentially contradicting events and the risk of falsification.¹¹⁷ "Theories are valued largely for their explanatory power and simplicity [...]",¹¹⁸ so the scientist's objective should always be to strive for more general and more precise hypotheses.¹¹⁹

3.2.2 Empirical Content, Logical Scope, and Falsification

The logical scope of a hypothesis describes the class of logical possibilities that is compatible with it. Logical scope and empirical content are converse to each other: the latter covering the class of logical possibilities that are incompatible with the hypothesis.¹²⁰ An example is in order. We assume that a company increases its promotional activities, implying three possible outcomes: sales will increase, stay constant, or decrease. If we hypothesize that sales increase with increased promotional activity, the logical scope (=increasing sales) of the hypothesis is small while the empirical content (=constant or decreasing sales) is large. The notion of constant or decreased sales is incompatible with the hypothesis. Should this notion be made, the hypothesis would be proven wrong or falsified. If we restate our hypothesis to "Sales will increase or stay constant with increased promotion", the logical scope has grown compared to the first case, whereas the empirical content is smaller. It has become more difficult to falsify the hypothesis, because now more outcomes are compatible with the hypothesis. In case of a statement claiming that sales will increase, stay constant or decrease with increased promotion the logical scope is at its maximum, because all conceivable outcomes are now compatible with the statement. Unfortunately, the empirical content is zero and the statement cannot be falsified anymore. It follows that the more outcomes a statement excludes, the larger is its empirical or informational content and the more will it tell about reality. A theory with a larger class of incompatible outcomes is more bound to fail – it is easier falsified.¹²¹ Falsificationism in the modern philosophy of science stems from Popper's "The Logic of Scientific Discov-

¹¹⁶ Schanz (1988), pp. 33f.

¹¹⁷ Cf. Chmielewicz (1994), p. 124.

¹¹⁸ Bakker/Clark (1988), p. 4.

¹¹⁹ Cf. Schanz (1988), p. 34.

¹²⁰ Cf. Schanz (1988), pp. 35f.

¹²¹ Cf. Popper (1989), p. 77.

ery”.¹²² The so-called approach of “critical rationalism”¹²³ rejects verification and the possibility that a hypothesis or theory can ever definitely be proven to be true, because a finite number of observations never allow conclusions to be drawn about an infinite number of possible outcomes.¹²⁴ Many believe that critical rationalism is superior to other epistemological approaches in marketing.¹²⁵ In the social sciences, if rigorous testing via observations and experiments in reality provides evidence against a statement, the statement is falsified and should be rejected. Until then, the statement is tentatively entertained.¹²⁶ To summarize, a good theory has much empirical content, thus offering many possibilities for falsification, but always withstands the attempt to do so.¹²⁷

3.2.3 The ‘Triangular Problem’ of Novelty, Truth, and Empirical Content

The basic necessity of a theory is truth, but truth is not sufficient.¹²⁸ High empirical content is also important, but unfortunately a conflict of aims between truth and high empirical content of F-determined statements hinders theory development. This conflict induces that the better fulfilment of aim A_1 (truth) results in a worsened position for aim A_2 (empirical content).¹²⁹ There are few theories in the social sciences that claim to be true always and everywhere.¹³⁰ Sometimes depicting the world realistically is not even the goal of a theory, but presenting a simplified or distorted picture of the world.¹³¹ Since there is a trade-off between a high likelihood and high empirical content, scientists must emphasise one of the two. They usually prefer high empirical content.¹³² A hypothesis with a high likelihood can be highly probable just because it does not tell much or nothing at all.¹³³

The former reflections can be extended by novelty to the ‘triangular problem’ (see fig. 1, p. 76). Novelty can either be expressed in a totally new idea, or in making new

¹²² Cf. Durbin (1988), p. 103; Popper (1980); the first edition was issued in German in 1934 (with date of 1935); for a short critique of Popper, cf. Chalmers (2001), pp. 73-86.

¹²³ Cf. Albert (1960).

¹²⁴ Cf. Suppe (1977), p. 167; Klotten/Kuhn (1965), p. 311.

¹²⁵ Cf. Raffée (1995), col. 1674; Easton (2002), p. 104.

¹²⁶ Cf. Chalmers (2001), p. 52.

¹²⁷ Cf. Chalmers (2001), p. 56.

¹²⁸ Cf. Chmielewicz (1988), p. 456.

¹²⁹ Cf. Chmielewicz (1994), p. 129.

¹³⁰ Cf. Bayer/Stölting (1994), p. 304.

¹³¹ Cf. Eberhard (1999), p. 15.

¹³² Cf. Popper (1989), p. 314.

¹³³ Cf. Popper (1989), p. 352. An example is the saying “If the cock screams the weather changes or stays like it is”, which is always correct but does not help at all.

connections of ideas already known, or creating a new form of representing an idea. The generalized conflict of aims exists between the search for truth, empirical content and novelty. Fulfilling two out of those three objectives can be simple. Novelty and truth are expressed in trivialities that have no empirical content; novelty and empirical content without truth are found in fantastic speculations; truth and empirical content without novelty are e.g. found as plagiarisms of existing theories. Besides of empirical content, novelty is the dominating objective for scientific statements,¹³⁴ though major breakthroughs are only achieved if all three conditions are fulfilled.

3.3 Fields of Application of a Theory

Theories are created to solve problems of theoretical or practical relevance.¹³⁵ The first category contains intellectually stimulating problems,¹³⁶ and those with important implications for theoretical systems.¹³⁷ The second category subsumes problems that real persons regard as important for their actions.¹³⁸

3.3.1 Description and Explanation of Reality

Describing real facts and events – though not offering much reputation – is a distinctive and essential part of scientific work. In the field of marketing, there are many descriptions of particular cases, e.g. about tendencies of concentration in business sectors, distribution channels, market shares etc.¹³⁹ Popper pointed out the essence of theorizing in a metaphor: “The theory is the net we cast out to catch ‘the world’ – for rationalisation, description and domination”,¹⁴⁰ i.e. theories are created to simplify, describe, and understand our environment.

Schanz claims that the ability to explain is the most important property of theories.¹⁴¹ To be explained (the explanandum) with the help of theories are why-questions, the answers to which provide reasons that explain why things are in one way and not the

¹³⁴ Cf. Chmielewicz (1994), pp. 131f.

¹³⁵ Cf. Franke (2002), pp. 13f.

¹³⁶ Cf. Zaltman/Lawther (1979), pp. 501f.

¹³⁷ Cf. Witte (1998), p. 740.

¹³⁸ Cf. Schanz (1992), p. 58.

¹³⁹ Cf. Müller-Hagedorn (2000), p. 29.

¹⁴⁰ Popper (1989), p. 31; [“Die Theorie ist das Netz, das wir auswerfen, um ‘die Welt’ einzufangen, - sie zu rationalisieren, zu erklären, und zu beherrschen“]. The original metaphor was written by Novalis: “Hypotheses are nets, only he will catch, who casts out...” [“Hypothesen sind wie Netze, nur der wird fangen, der auswirft...”]; Novalis (1789).

¹⁴¹ Cf. Schanz (1988), p. 56.

other.¹⁴² In marketing this could be employing the neoclassical notion that increased prices for normal goods *ceteris paribus* (c.p.) decrease the consumers' propensity to buy,¹⁴³ or the thesis from the behavioural sciences that satisfaction exercises an effect on customer loyalty.¹⁴⁴ One law and at least one secondary condition or assumption is necessary to explain problems found in reality. If we want to explain why a customer is very loyal to a coffee-brand, we can find the law "Customers who experience satisfaction with a good or service will be loyal". In connection with the exemplary secondary condition "The customer loves the taste and smell of his coffee", the problem is solved. If the law is assumed to be true, the secondary condition causes loyalty. This scheme of logical deduction of an explanandum from an explanans (law and secondary condition) is called "Hempel-Oppenheim-" or "Hempel-Popper-Scheme".¹⁴⁵ Hempel and Oppenheim put up four constituting demands for the simple explanation (which is called deductive-nomological or DN-explanation): Firstly, the explanandum must be a logical consequence of the explanans. Secondly, the explanans must contain at least one law. Thirdly, the explanans must have empirical content and, fourth, the explanans must be true.¹⁴⁶ If one considers the rejection of verification, the last demand diminishes to "the explanans may not have been falsified so far". Another, not generally accepted demand is the possibility of independently testing explanandum and explanans to avoid ad-hoc and circular explanations.¹⁴⁷

3.3.2 Prediction of Future Incidents and Technological Use

Since "[p]redictions can be seen as the bridge between science and action",¹⁴⁸ successful predictions often turn out to "[...] mark the turning point in acceptance of a theory that has been offered".¹⁴⁹ Prognoses are those predictions that are based on theories.¹⁵⁰ Schneider sees the origin of predictive theories in the missing link between empirical problems and best-practice examples. The explanatory theory sys-

¹⁴² Cf. Bunge (1967b), pp. 3-9.

¹⁴³ Cf. Varian (1999), p. 98.

¹⁴⁴ Cf. e.g. Anderson/Sullivan (1993); for an overview, cf. Homburg/Giering/Hentschel (1999), pp. 93-96.

¹⁴⁵ Cf. Hempel (1965), pp. 335-354; Popper (1989), pp. 31f.

¹⁴⁶ Cf. Hempel (1965), pp. 247f.

¹⁴⁷ Cf. Popper (1972), pp. 30f.

¹⁴⁸ Schanz (1988), p. 65; ["Voraussagen können gleichsam als Brücke zwischen Theorie und Handlung betrachtet werden"].

¹⁴⁹ Bakker/Clark (1988), p. 21.

¹⁵⁰ Cf. Schanz (1988), p. 65.

tematizes existing knowledge and then offers solutions for the future.¹⁵¹ The initial situation for predictions is opposed to that of explanations (see fig. 2, p. 76). In the latter case, what was to be explained was given; fitting secondary conditions and one or more laws were to be found. Predictions work the other way round: the goal is to derive predictions from the given laws and secondary conditions. A predicted incident is contingent on two conditions: at first, the secondary conditions have to materialize and second, the relevant laws must be powerful. Laws with a high empirical content allow predictions because they rule out the possibility that certain events happen in the future.¹⁵² A non-technological prognosis does not offer exact suggestions for action because the occurrence of the secondary conditions is not controllable. The prognosis will be flawless only if those conditions can be actively controlled (technological prognosis).¹⁵³

Technological prognoses are feasible only after transforming a theory into its technological form, which is a tautological transformation to clarify the relevance for practical problems.¹⁵⁴ The transformed theory puts forward a ‘technique’ or ‘policy’.¹⁵⁵ The cause/effect-framework is changed to a means/ends-framework.¹⁵⁶ Kotler claims that “[m]arketing is a descriptive science involving the study of how transactions are created, stimulated, facilitated and valued. Marketing management is a normative science involving the efficient creation and offering of values to stimulate desired transactions”.¹⁵⁷ The task of marketing technology thus becomes assisting “[...] marketing decision makers by developing normative decision rules and models, [...] based on the findings of marketing science”.¹⁵⁸

3.3.3 A Theory as a Device for Criticizing Social and Ideological Conditions

Theories from the social sciences can be used to criticize social or ideological conditions. As a theory allows conclusions to be drawn about the relations of causes and effects in reality, it informs us not only about a given state, but about possible situations as well. Questions about the consequences of different measures are answered with the help of theoretical knowledge. It becomes possible to criticize current social

¹⁵¹ Cf. Schneider (2001), p. 273.

¹⁵² Cf. Schanz (1988), pp. 65-68.

¹⁵³ Cf. Albert (1964), p. 62.

¹⁵⁴ Cf. Schanz (1988), pp. 76-78.

¹⁵⁵ Cf. Albert (1984), p. 206.

¹⁵⁶ Cf. Chmielewicz (1994), pp. 11f.

¹⁵⁷ Kotler (1972), p. 52.

¹⁵⁸ Hunt (1983), p. 12.

realities using this information.¹⁵⁹ Criticism of ideologies via theories is established on the claim that well-founded theories inform about prejudices. Ideologies which often claim to be based on scientific theories can only be successfully attacked with superior theories.¹⁶⁰

4 Fundamentals of Austrian Economics

The Austrian school of economics, which originates from the publication of Carl Menger's 'Principles of Economics' in 1871,¹⁶¹ is a serious adversary of the neoclassical framework in the field of microeconomics.¹⁶² Both schools attempt to explain the functioning of markets, but while neoclassicism refers to the static model of equilibrium analysis, Austrianism regards market coordination as a truly dynamic process.¹⁶³

4.1 Assumptions of Austrian Economics

The following five core assumptions of Austrian economics are the point of departure for the description and explanation of the market process:

- (1) Methodological individualism.
- (2) (Radical) Subjectivism.
- (3) Individuals differ and they have a will to change and create their future.
- (4) Space and time are influential.
- (5) (Radical) ignorance of market actors influences the market process.¹⁶⁴

(1) Methodological individualism:

Methodological individualism refers to the practice of viewing social entireties such as national economies as the product of individual action. This assumption has been part of Austrian economics at all times.¹⁶⁵ "Economics is not about things and tangi-

¹⁵⁹ Cf. Schanz (1988), pp. 82f.

¹⁶⁰ Cf. Albert (1964), p. 70.

¹⁶¹ Cf. Smith (1986), p. vii.

¹⁶² Cf. Kerber (1997), p. 33. For a neoclassical critique of Austrianism, cf. Caplan (1999); for an Austrian critique of neoclassicism cf. Block/Barnett II/Wood (2002).

¹⁶³ Cf. Lingner (1993), pp. 70-72; 168; Hayek (1949), p. 94.

¹⁶⁴ Cf. Rese (2000), p. 66.

¹⁶⁵ Cf. Christainsen (1994), p. 11.

ble material objects; it is about men, their meanings and actions”,¹⁶⁶ because “[u]ltimately, the entire social system, its prices, costs, supply, demand, the division of labour, money etc, must be traced to their roots in the actions, decisions and plans of individuals [...]”.¹⁶⁷ The individual as the key to all economic effects on markets must be regarded as the superstructure of Austrianism which predetermines all scientific research.¹⁶⁸

(2) *(Radical) Subjectivism:*

Subjectivism and its variation of radical subjectivism is firstly an approach to the study of human interaction with things or other humans and secondly the major tenet that distinguishes Austrians from neoclassicism. Economists who try to explain human interaction must start with the subjective meaning the individuals attach to their actions and their subjective mental states.¹⁶⁹ “So far as human actions are concerned the things are what the acting people think they are [...] [and] unless we can understand what the acting people mean by their actions, any attempt to explain them [...] is bound to fail”.¹⁷⁰ The perceived marginal utility, a strictly subjective judgment, determines the value of a good for a consumer, and hence its price.¹⁷¹ These subjective value judgments for identical goods determine the attractiveness of exchanges. The discrepancy explains the positive net value of exchange.¹⁷² Subjective value judgments depend on subjective knowledge.¹⁷³ The so-called ‘radical subjectivists’, most notably Lachmann and Shackle, assume that human actors decide on expectations of the future which they have at the moment of decision.¹⁷⁴ Individual expectations differ because the future is unknown and unforeseeable.¹⁷⁵ New knowledge that comes in the course of time is responsible for the incompatibility of the actors’ plans with those of others at any point in time.¹⁷⁶ Equilibrating forces are always overtaken by unexpected and disequilibrating change before a long-run general equilibrium is

¹⁶⁶ Mises (1949), p. 92.

¹⁶⁷ Kirkpatrick (1983), p. 46.

¹⁶⁸ Cf. Rese (2000), p. 67.

¹⁶⁹ Cf. Horwitz (1994), p. 17.

¹⁷⁰ Hayek (1952), pp. 44; 53.

¹⁷¹ Cf. Kirkpatrick (1983), pp. 46f.

¹⁷² Cf. Rese (2000), p. 67.

¹⁷³ Cf. Horwitz (1994), p. 18.

¹⁷⁴ Cf. Kirzner (2000), p. 46.

¹⁷⁵ Cf. Lewin (2000), p. 387.

¹⁷⁶ Cf. Moss (2000), p. 369.

reached. Markets for particular goods may temporarily find equilibrium, but the whole economy never does.¹⁷⁷

(3) Individuals and their will to change and create:

The differences of individuals manifest themselves in divergent endowments and divergent experiences, resulting in dissimilar knowledge, values and heterogeneous expectations.¹⁷⁸ Constrained by incomplete wisdom, human beings are creative and act toward change. They have the capacity of acting with self-interest and purpose to pursue the satisfaction of their hierarchy of needs. This innate quality in humans is identified as *homo agens*, the acting man who makes conscious, reasoned decisions.¹⁷⁹ Mises identifies three reasons for human action: first, “[a]cting man is eager to substitute a more satisfactory state of affairs for a less satisfactory”. Second, he “[...] imagines conditions that suit him better, and his action aims at bringing about this desired state”. Third, the actor has “[...] the expectation that purposeful behaviour has the power to remove or at least alleviate the felt uneasiness”.¹⁸⁰ His will to move into a (subjectively perceived) preferable state of affairs in connection to different endowments fuels the market process.¹⁸¹ Since each individual is unique, everyone can perceive different ends. Some strive for sexual satisfaction, food, material things, but they may as well care for altruistic or the so-called higher goals.¹⁸² For Austrians, economic theory is ‘praxeology’, the science of human action.¹⁸³ The axioms of praxeology are supposed to be true and meaningful, because they are the essence of human being. A verbal deduction of the implications of praxeology is true and meaningful as well, mathematical symbolization superfluous.¹⁸⁴

(4) The influence of space and time:

The influence of space and time is very important in Austrian theorizing. If time is perceived as a flow of events, it brings novelty and surprises. Living and acting today is connected to tomorrow’s actions, since individual experience of today’s events alters tomorrow’s perception of events.¹⁸⁵ The elapse of time permits the gaining of

¹⁷⁷ Cf. Lachmann (1976), pp. 60f.

¹⁷⁸ Cf. Rese (2000), p. 68.

¹⁷⁹ Cf. Oakley (1997), p. 5.

¹⁸⁰ Mises (1949), pp. 13f.

¹⁸¹ Cf. Rese (2000), p. 68.

¹⁸² Cf. Mises (1949), p. 14.

¹⁸³ Cf. Prychitko (1994a), p. 77.

¹⁸⁴ Cf. Rothbard (1976), p. 22.

¹⁸⁵ Cf. O’Driscoll Jr./Rizzo (1985), p. 3.

new experiences, which acknowledges the creation and alteration of knowledge.¹⁸⁶ Newly discovered knowledge often makes clear to the economic actors that their expectations of the future were wrong and in need of revision.¹⁸⁷ In the course of these revisions and through actor's learning of truly novel things, the market process becomes an engine of discovery.¹⁸⁸ In this sense, the Austrian theory of entrepreneurship critically depends on a dynamic perception of time.¹⁸⁹

(5) Radical ignorance and its influence on the market process:

Kirzner distinguishes two kinds of ignorance: rational ignorance and radical (sheer, utter) ignorance. In the former case, actors maximize profit or utility with foreseeable knowledge. The actors are aware of their amount of knowledge and they are aware of the fact that if they accept certain expenses of money or time, they can gain additional knowledge in a planned search. The search for additional information is conducted until the marginal return of information equals the marginal cost for the search, so that an optimum is attained. Rational ignorance conforms to neoclassical theory.¹⁹⁰ The latter case is in line with the Austrian framework, where the existence of radical ignorance is assumed. Being radically ignorant instead of ignorant by choice does not only mean that there is not any prior knowledge concerning the costs and benefits of becoming aware of some novel facts,¹⁹¹ but it refers to the total (radical, sheer) unawareness of the existence of knowledge that is not known so far. New facts may be accidentally learned by chance or inevitably during participation in the market process.¹⁹² If actors possessed knowledge of things unknown so far, it would certainly affect their plans.¹⁹³ Thus, ignorance allows for opportunities in the market process, which alert entrepreneurs may recognize and exploit (see section 4.2.1, pp. 22-24).¹⁹⁴

4.2 The Working of the Market Process

Austrian economic theory explains how information influences the decisions of market actors and how the market succeeds in distributing relevant information to those who will make the best use of it. The problem of information has already been solved

¹⁸⁶ Cf. Lachmann (1959), p. 73.

¹⁸⁷ Cf. Moss (2000), p. 369.

¹⁸⁸ Cf. O'Driscoll Jr./Rizzo (1985), p. 9.

¹⁸⁹ Cf. Rese (2000), p. 69.

¹⁹⁰ Cf. Kirzner (1992), pp. 154f.

¹⁹¹ Cf. Ikeda (1994), p. 23.

¹⁹² Cf. Hayek (1937), p. 51; Hayek (1994), p. 249; Kirzner (1988), pp. 32-34.

¹⁹³ Cf. Hayek (1937), p. 51.

¹⁹⁴ Cf. Kirzner (1973), pp. 66f.; Kirzner (1988), pp. 152f.

in neoclassic theory due to the assumption of individual with perfect knowledge.¹⁹⁵ In the following part it will be explained and described how the market process solves the informational problem in Austrian economics.

4.2.1 The Market Process under the Influence of Ignorance

The interaction of market participants or market actors – consumers, entrepreneur-producers and resource owners – takes place in a market,¹⁹⁶ so it can be said that the market is the result of interacting decisions of market actors during a given period of time.¹⁹⁷ Yet, a market must not be regarded as a static place for interaction. The market is only delimited from an individual perspective. Each actor perceives the boundaries of the market differently, depending on his radical ignorance. In an extreme case, a market may only consist of two actors: one buyer and one seller. This extreme Austrian micro-perspective is incompatible with the idea of a single market where all suppliers of one good compete against each other.¹⁹⁸ The people who interact in the market try to fulfil plans by buying and selling.¹⁹⁹ They hope to enhance their situation and to reach advantages through exchange.²⁰⁰ The *homo agens* in Austrian economics is, in contrast to the *homo oeconomicus* of neoclassical economics, not limited to given means and ends. He has the will and alertness to subjectively formulate ends worth striving for and finding the means necessary to reach his ends. His decisions are economizing on the basis of his chosen ends and known means, i.e. the actor tries to most efficiently maximize ends with available means. With respect to his knowledge it can be said that he acts subjectively rational.²⁰¹ Each actor has a different endowment of abilities and objectives (wants and needs), and possesses incomplete and diverging knowledge about current demand and supply, prices and qualities. Market participants formulate their expectations and make plans on this basis.²⁰² Successful actors and their counterpart in the market offer each other the best opportunity each one knows of.²⁰³ Being successful may turn out to be difficult, because “[...] knowledge of the circumstances of which we must make use never exists in concentrated or integrated form, but solely as the dispersed bits of incom-

¹⁹⁵ Cf. Kirzner (1988), p. 45.

¹⁹⁶ Cf. Kirzner (1973), p. 6.

¹⁹⁷ Cf. Kirzner (1973), p. 9.

¹⁹⁸ Cf. Rese (2000), pp. 74-76.

¹⁹⁹ Cf. Kirzner (1973), p. 71.

²⁰⁰ Cf. Plinke (2000b), p. 59.

²⁰¹ Cf. Kirzner (1973), p. 33.

²⁰² Cf. Rese (2000), p. 71; Plinke (2000b), p. 63.

²⁰³ Cf. Kirzner (1973), p. 12.

trated or integrated form, but solely as the dispersed bits of incomplete and frequently contradictory knowledge which all the separate individuals possess”.²⁰⁴ “As action necessarily is directed toward influencing a future state of affairs, [...] it is affected by every incorrectly anticipated change in the data [...], [and] [...] the outcome of action is always uncertain. Action is always speculation”,²⁰⁵ which implies that some plans that have been formulated are disadvantageous – they will either fail or not fully exploit market opportunities. When plans cannot be executed, the actors may realize that they have been overly optimistic concerning the decisions of other market actors; or they realize that they have missed potential profit because they were too pessimistic about market conditions.²⁰⁶ In any case, new information flows back to the market participants as a result of market interaction. Actors in the market learn from experience and systematically modify and revise their plans, which led to suboptimal decisions, for the next period of interaction.²⁰⁷ Since single market transactions are not independent, but influence each other in many ways, all market actors are engaged in the revision of plans. Since one period is not enough to disclose all market knowledge to the actors, there is again a significant probability that both correct and incorrect decisions will be made in the following period of market interactions.²⁰⁸ The actor’s ability to learn from prior misjudgements and to test newly revised plans in the market sets the market process in motion.²⁰⁹ The market thus becomes a means of discovering and disseminating “[...] knowledge of the particular circumstances of time and place”.²¹⁰ In this system knowledge about preferences and technologies is dispersed among many people. Prices for the diverse goods and services send a signal that fulfils the function of coordinating the actions of the separated individuals.²¹¹ Prices offer unambiguous incentives that tell the market actors which products are valued most highly. Market actors recognize what to do and produce,²¹² since they try to gain profits and avoid losses.²¹³ If the actors’ current decisions incorrectly anticipate the decisions made by others, a state of disequilibrium prevails.²¹⁴ In this case, prices

²⁰⁴ Hayek (1945), p. 519.

²⁰⁵ Mises (1949), p. 253.

²⁰⁶ Cf. Kirzner (1973), p. 10.

²⁰⁷ Cf. Plinke (2000b), p. 63; Kirzner (1973), p. 71.

²⁰⁸ Cf. Plinke (2000b), p. 59

²⁰⁹ Cf. Plinke (2000b), p. 59; Kirzner (1973), p. 10.

²¹⁰ Hayek (1945), p. 521; cf. Kirzner (1988), p. 32; Lachmann (1976), p. 59.

²¹¹ Cf. Hayek (1945), p. 526; Hayek (1994), p. 253; Hayek (1996), p. 309.

²¹² Cf. Hayek (1994), p. 258.

²¹³ Cf. Mises (1949), pp. 325f.; Kirzner (1990), p. 29; Baird (1994), p. 147.

²¹⁴ Cf. Kirzner (1988), p. 127.

reflect defective information.²¹⁵ The market process of mutual anticipation of plans continues until correct foresight drives all ignorance out of the market.²¹⁶ Without exogenous change in preferences, technological possibilities or resource availability, all decisions made by buyers, sellers and producers will inevitably be aligned, all plans will be correctly executed and the market will reach a state of equilibrium.²¹⁷

4.2.2 Entrepreneurship in the Market Process

The concept of the entrepreneur is central for the market process,²¹⁸ but the societal role that entrepreneurs fulfil is feasible only in the presence of ignorance.²¹⁹ To clarify this, we will imagine a market where nobody is able to learn from experience, so that all actors infinitely repeat the same decisions. There are six possible outcomes of market interaction (see fig. 3, p. 76):²²⁰

- (1) Would-be-buyers return home empty-handed, because they offered to pay an insufficient price. They did not learn to outbid competitive buyers.
- (2) Buyers were able to buy and they paid an appropriate price.
- (3) Buyers could buy but they paid too much. They did not realize that they could get the same goods at a lower price.
- (4) Sellers did not sell everything or no goods at all. They asked too high prices and did not learn to underbid competitive sellers.
- (5) Sellers could sell and received an appropriate amount of money.
- (6) Sellers could sell but received not enough. They did not realize that they could sell their goods for a higher price.

We introduce a group of outsiders into this world – entrepreneurs – who are able to learn from experience and to recognize opportunities for entrepreneurial profits. They are not necessarily interested in buying for themselves,²²¹ but they are alert to where a good can be sold at a higher price than the purchase price. In our market of ignorant actors these entrepreneurs would instantaneously perceive profit opportunities that

²¹⁵ Cf. Kirzner (1988), pp. 16f.

²¹⁶ Cf. Hayek (1937), pp. 41f.; Hayek (1994), pp. 255f.

²¹⁷ Cf. Kirzner (1973), pp. 10f.

²¹⁸ Cf. Plinke (2000b), p. 59.

²¹⁹ Cf. Kirzner (1988), pp. 68; 153.

²²⁰ Cf. Kirzner (1973), p. 14; Plinke (2000b), pp. 60f.

²²¹ Cf. Picot/Reichwald/Wigand (2001), p. 34.

arise from engaging in arbitrage in cases three and six: first, the entrepreneurs would buy resources from sellers who did not realize that they could charge more (case six). Next, the entrepreneurs would sell the goods to those buyers who did not realize that they could buy identical goods for less money (case three).²²² Successful entrepreneurship can attract imitators and competitors who try to outdo the original entrepreneur with better deals.²²³ “The competition between the various entrepreneurs will move them to offer to buy from the low-price sellers, at prices higher than these sellers had thought possible; entrepreneurs in competition will also sell to high-price buyers at prices lower than these buyers had thought possible”.²²⁴ Competition will move prices to a correct estimate of the participants’ eagerness to buy.²²⁵ In his attempt “[...] to offer opportunities which market participants will consider more attractive than those available elsewhere [...]”, the entrepreneur relieves “[...] the consumer of the necessity to be his own entrepreneur”.²²⁶ Profitable opportunities for arbitrage lure entrepreneurs to their discovery. The opportunity is exploitable until entrepreneurs in the competitive market process have reallocated all resources to a new equilibrium, where both opportunity and the misallocation of resources are eliminated.²²⁷ Sometimes discoveries are disequilibrating and even increasing ignorance,²²⁸ but in general the market process does not only lead to an adjustment of individual plans, but also to a state in which everything that is produced will be produced by those who can make it cheaper than (or equally cheap as) the next-best competing entrepreneur. Everything will be sold at a cheaper (or the same) price than the next-best competing entrepreneur asks.²²⁹

The entrepreneurs are the “driving force of the whole market system”,²³⁰ and the entrepreneurs in competition systematically force the economy towards equilibrium; their alert exploitation of opportunities brings the economy in line with the information available.²³¹ Kirzner’s entrepreneur conforms to Mises’ and Hayek’s notion that “[...] a tendency towards equilibrium exists” since “[...] under certain conditions [...]”

²²² Cf. Kirzner (1973), pp. 14f..

²²³ Cf. Rese (2000), p. 79.

²²⁴ Kirzner (1973), p. 15.

²²⁵ Cf. Kirzner (1973), p. 15.

²²⁶ Kirzner (1973), p. 136.

²²⁷ Cf. Kirzner (1988), p. 108.

²²⁸ Cf. Kirzner (1992), p. 45.

²²⁹ Cf. Hayek (1994), p. 256.

²³⁰ Mises (1949), p. 249.

²³¹ Cf. Kirzner (1988), p. 134; Kirzner (1997), p. 62.

the expectations of the people and particularly of the entrepreneurs will become more and more correct".²³² However, an equilibrium need not necessarily be reached because equilibrating processes are continually interrupted by changes in the underlying variables (preferences, resource availabilities, technological possibilities), which initiate new equilibrating processes.²³³

It is the entrepreneur's alert mind that observes and exploits profitable differences in the pattern of relative prices.²³⁴ The pure entrepreneur acts as an arbitrageur of opportunities. He does not need any initial endowment with resources. Entrepreneurship is therefore a costless activity. The sole prerequisite to compete is free market entry, which is always given in the absence of a monopoly over an essential input. Consequently, everybody can be an entrepreneur.²³⁵ The focus of entrepreneurship is not on a particular group of men, but on a function.²³⁶ The distinctive characteristics of entrepreneurs as opposed to non-entrepreneurs are aggressiveness, boldness, creativeness, and leadership qualities which are all manifested in alertness.²³⁷ Alertness is a refined, abstract form of the knowledge of how to collect and employ information and resources.²³⁸ Alertness on its own is not sufficient for progress in the market process; it just offers chances that may be seized.²³⁹ It is difficult to deliberately search for pure profit opportunities because radical ignorance is an obstacle to the discovery of such opportunities.²⁴⁰ The Kirznerian entrepreneur is responsive to opportunities already existent and waiting to be noticed.²⁴¹ In the multi-period case of the market process entrepreneurs are creatively and imaginatively shaping the future through responsiveness to intertemporal opportunities.²⁴²

Entrepreneurs may engage in the so-called pure arbitrage by selling items for more than they paid. Entrepreneurship is also consistent with intertemporal arbitrage, if items are bought at a lower price in one period than they are sold for in a subsequent

²³² Hayek (1937), p. 44; cf. Kirzner (1997), p. 62; cf. also Mises (1949), p. 352: "Both the logical [Austrian] and the mathematical [neoclassical] economist assert that human action ultimately aims at the establishment of such a state of equilibrium and would reach it if all further changes in data were to cease".

²³³ Cf. Kirzner (1992), pp. 42; 45.

²³⁴ Cf. Lachmann (1976), p. 56; Kirzner (1988), p. 152; Kirzner (1992), p. 50.

²³⁵ Cf. Kirzner (1973), p. 16; Ikeda (1994), p. 25.

²³⁶ Cf. Mises (1949), p. 252.

²³⁷ Cf. Kirzner (1999), p. 13.

²³⁸ Cf. Kirzner (1988), p. 19.

²³⁹ Cf. Kirzner (1988), p. 18; Rese (2000), p. 76.

²⁴⁰ Cf. Kirzner (1997), p. 71.

²⁴¹ Cf. Kirzner (1973), p. 74.

²⁴² Cf. Kirzner (1985), pp. 63f.

period.²⁴³ The third option is that entrepreneurs recognize errors of coordination between the sum of prices for a bundle of resources needed to produce a product and the price of the output on the product market. Although they engage in the transformation of resources into a higher-state product, they still do not need to contribute resources of their own.²⁴⁴ The entrepreneur does not even need capital funds in case of time-consuming production, if the opportunity is sufficient to enable him to offer an attractive interest payment.²⁴⁵

4.2.3 Price Rivalry, Non-Price Rivalry, and Monopolistic Competition

The market process advances only if alertness is paired with successful entrepreneurship, which fulfils three notable criteria. First, the subjective perception of an opportunity must be congruent with the objective data. Second, the entrepreneur's offer must be the most advantageous in comparison to others. Third, the entrepreneur must make the relevant market aware of his advantageous offer.²⁴⁶ While the first criterion is self-evident, the others deserve explanation.

Acting men are in the favourable state of choosing between various opportunities,²⁴⁷ from which they will choose the most attractive. An opportunity is more attractive if a lower (higher) price is required (offered) for the same product, from which follows that entrepreneurial competition takes the form of competition for the best price. An opportunity is also better compared to another one, if it offers buyers a more desirable product for a given price respectively if it asks of sellers something they relinquish less reluctantly. That is why competition takes place in the kinds and qualities of goods and services as well,²⁴⁸ which means that product differentiation is essential for entrepreneurial success in the face of competition.²⁴⁹ Consumers' wishes and desires are not obvious facts, but problems to be solved in the market process.²⁵⁰ Mises stresses the primacy and sovereignty of the consumers over entrepreneurial action in regard to this. At first glance entrepreneurs are responsible for production and they are steering the economy, but in fact they are obeying the consumer's orders. If entrepreneurs do not pay attention to the continually changing tastes and desires for goods

²⁴³ Cf. Kirzner (1992), p. 50.

²⁴⁴ Cf. Kirzner (1973), p. 44; Kirzner (1992), p. 50.

²⁴⁵ Cf. Kirzner (1973), p. 49.

²⁴⁶ Cf. Rese (2000), pp. 76f.

²⁴⁷ Cf. Mises (1949), p. 94.

²⁴⁸ Cf. Kirzner (1973), pp. 23f.; 135.

²⁴⁹ Cf. Kirkpatrick (1983), p. 47; Kirzner (1988), p. 21.

²⁵⁰ Cf. Kirzner (1988), p. 33.

and services, they will be driven out of the market.²⁵¹ Strictly speaking, consumers are not longing “[...] for tangible goods as such, but for the services which these goods are fitted to render them”.²⁵²

The third criterion is necessary because “[t]he consumer is not omniscient. He does not know where he can obtain at the cheapest price what he is looking for. Very often he does not even know what kind of commodity or service is suitable to remove most efficaciously the particular uneasiness he wants to remove. [...]. To convey to him information about the actual state of the market is the task of business propaganda”.²⁵³ The entrepreneur must not only make information available to consumers, his success crucially depends on the consumers’ awareness of a purchase opportunity. In wealthy societies with a broad range of products, more and more provocative advertising is necessary to alert market participants to the diversity of offers.²⁵⁴ In the 1940s Mises recognized that “[b]usiness propaganda must be obtrusive and blatant. [...] Advertising is shrill, noisy, coarse, puffing, because the public does not react to dignified allusions. It is the bad taste of the public that forces the advertisers to display bad taste [...]”.²⁵⁵ To conclude, entrepreneurial alertness includes anticipating the needs and wants of consumers, designing and developing products to satisfy those needs at competitive prices, and making the opportunity available at such a location and especially through information that the consumer cannot miss it.²⁵⁶

The alert entrepreneur who is the only producer capable of offering a differentiated good or service at a given point in time is in the favourable position of having a temporary monopoly from a short-run perspective. He can reap above-average returns, but a position without unique resource ownership is vulnerable to imitation in a competitive environment and subsequent erosion of high margins in the longer run.²⁵⁷ The only possibility to eliminate competition and to reach a protected monopoly in the absence of legislative barriers is the exclusive control of an essential

²⁵¹ Cf. Mises (1949), p. 270; cf. also pp. 227, 258f.

²⁵² Mises (1949), p. 234. The economic system seen as a means to satisfy consumer needs goes back to Carl Menger, as well as the notion that items bought and sold in the market are valued only insofar as they contribute toward need satisfaction; cf. Kirzner (1992), p. 71.

²⁵³ Mises (1949), p. 316.

²⁵⁴ Cf. Reekie (1994), pp. 158f.

²⁵⁵ Mises (1949), pp. 316f.

²⁵⁶ Cf. Kirzner (1983), pp. 47f.

²⁵⁷ Cf. Kirzner (1973), pp. 133f.; Jacobson (1988), p. 415. A monopoly is understood as a position immune of competitive entry, so a competitive environment on the contrary is marked by free entry to the market; cf. Kirzner (1973), p. 131; Ikeda (1994), p. 25.

absence of legislative barriers is the exclusive control of an essential resource.²⁵⁸ A long-run monopolistic position may be held due to initial resource endowments, e.g. if someone owns a unique natural skill. Alternatively, such a position may be won by alert entrepreneurial (and hence competitive) action.²⁵⁹ This happens if a market participant recognizes “the possibility of making large profits by buying up *all* the available supply of a given resource, and then establishing himself as the monopolist producer of a particular commodity”.²⁶⁰ Such an action is competitive in the long-run perspective because the entrepreneur made himself a monopolist resource owner in the course of his activities, a possibility that was *ex ante* open to all competing entrepreneurs.²⁶¹ Austrian economics implies the rejection of governmental interference into the market process despite the occurrence of monopolies,²⁶² because coordination in the decentralised market process is always superior to centrally planned coordination.²⁶³ This position should not be mistaken with *laissez-faire*, since Austrian economists clearly appreciate the necessity of institutions for the functioning of the market.²⁶⁴

4.3 Hypotheses of Austrian Economics

Austrian economics is focused on the equilibrating process that can be observed in markets, with emphasis being put on the role that information and entrepreneurship fulfil in the process. Despite of its long history, no formalised theory is to be found in the works of its representatives Mises, Hayek, or Kirzner, to name just a few. A complete epistemological analysis of Austrian economics is impossible without a set of hypotheses. Fortunately, the large amount of work on Austrian economics in verbal form and the fundamentals of Austrian economics put forward in this thesis allow the deduction of a number of possible hypotheses. The following hypotheses are a step-by-step reflection of the market process.

Prices can be very quickly adapted in regard to supply and demand, e.g. if the demand for a particular good is very high and keeps on rising while the produced amount remains fixed, prices can rise and still all goods produced will be sold. Prices are a

²⁵⁸ Cf. Kirzner (1988), pp. 114f.

²⁵⁹ Cf. Kirzner (1973), p. 131.

²⁶⁰ Kirzner (1973), p. 22; Italics in original.

²⁶¹ Cf. Kirzner (1973), p. 132.

²⁶² Cf. Hayek (1996), p. 163.

²⁶³ Cf. Kirzner (1992), p. 161.

²⁶⁴ Cf. Hayek (1996), p. 163.

piece of information that lures entrepreneurs either to produce more of a certain commodity or to slow down or stop production.²⁶⁵ Hypothesis H₁ follows:

H₁: If prices in a market are a measure of relative shortages, then they serve as a means of communicating information.

Hypothesis H₂ is not only a tautological transformation of the definition of the state of equilibrium (the market will be in equilibrium given perfect information), but here it is seen as an empirical observation from reality, that is hypothesized about. The incompleteness of information results in incorrect plans that lead to poorly adjusted plans and thus a state of disequilibrium.²⁶⁶

H₂: If information about supply and demand in a market is incomplete (if ignorance prevails), then the market will be in disequilibrium.

A market that is in disequilibrium is made up of various suboptimal exchange relations. Entrepreneurs, who are alert to the existing arbitrage-opportunities in such a market, can earn risk-less profits.²⁶⁷ Hypotheses H₃ and H₄ express this:

H₃: If the market for a good or service is in disequilibrium, then opportunities for arbitrage exist.

H₄: If opportunities for arbitrage exist, then alert entrepreneurs will appear to exploit these opportunities.

Entrepreneurial activities cause the generation of new knowledge, e.g. through an alteration of prices. Alert entrepreneurs perceive and interpret these new signals. Since making profits is the decisive entrepreneurial motive, some will try to gain a share of such opportunities by imitating and improving the original entrepreneur's offer,²⁶⁸ which is expressed in Hypothesis H₅:

H₅: If alert entrepreneurs exploit opportunities, then information about their activities spreads in the market in the course of time and imitators will be attracted.

The *homo agens* has the ability to learn and alter his plans. A reduction of his ignorance due to additional information will thus improve his decision-making capabili-

²⁶⁵ Cf. Hayek (1994), pp. 258f.; Hayek (1945), p. 526.

²⁶⁶ Cf. Kirzner (1988), p. 127.

²⁶⁷ Cf. Kirzner (1973), pp. 14f.

²⁶⁸ Cf. Rese (2000), p. 79.

ties.²⁶⁹ The buyer's enhanced plans will reward good offers in the market and punish bad offers through the allocation of resources.²⁷⁰ Furthermore, buyers profit from entrepreneurial sellers and their competitors in the market who drive down prices to an equilibrium level.²⁷¹ Buyer and seller thus start a tendency towards equilibrium. Hypotheses H₆ and H₇ follow:

H₆: If information spreads and imitators appear, then experience and learning result in enhanced decision-making and plans that mutually fit better.

H₇: If better mutual plans are made, then an equilibrating tendency commences.

5 A Review of Austrian Economics as a Marketing Theory

5.1 A Qualitative Assessment of Austrian Economics

The following section will critically evaluate the assumptions of Austrian economics in regard to its applicability for marketing theory and it will apply the criteria from the philosophy of science found in chapter three to the hypotheses of section 4.3 (p. 31) to assess the epistemological qualities of Austrian economics.

5.1.1 An Assessment of the Assumptions of Austrian Economics

(1) Methodological individualism:

On the one hand, the assumption that all social phenomena must be traced to individual decisions is certainly true. It is the people in a company and not the company as such who make decisions. The assumption of methodological individualism is congruent with marketing as far as the buyers of goods or services are individuals or at least a rather small group of interacting individuals. On the other hand, the idea of methodological individualism of always examining the roots of everything, like companies or nations, makes the analysis of their behaviour very complex and difficult. Only a minority point of view in Austrian economics claims that individual actions can be meaningfully aggregated. It is impossible to explain the continuous employment of empirical research and statistics in marketing with the view of the majority of scholars in Austrian economics. For them, market research is just speculation. The

²⁶⁹ Cf. Moss (2000), p. 369.

²⁷⁰ Cf. Jacobson (1992), p. 788.

²⁷¹ Cf. Kirzner (1988), p. 108.

success of companies or research departments specialised in market research tells a different story. Historical data is obviously valuable in predicting and planning future marketing strategies.

(2) (Radical) Subjectivism:

The assumption of subjectivism is the major difference between Austrian economics and neoclassicism and it is a necessary prerequisite for the existence and purposefulness of marketing. Marketing would indeed lose its justification if it could not exploit human subjectivity. The perceived value of goods can be influenced by marketing via its set of tools and instruments. This change would be unthinkable given the neoclassic assumption of perfect knowledge, but is possible given the more realistic assumptions about human decision making in Austrian economics. If all goods in a marketplace had an objective value, all exchanges would either stop or at least create no extra-value for anybody, because an equal amount of goods or money would be traded in exchange for the good. The assumption of subjectivism in Austrian economics gives the theory a foundation that is similar to the properties of real human beings.

There have been long arguments about the choice between subjectivism and radical subjectivism. Empirically, there is a tendency toward equilibrium in markets.²⁷² This evidence supports the Kirznerian point of view, although these tendencies might just be confined to submarkets. Since marketing is not interested in gaining implications for the whole economic system but rather for submarkets, the Kirzner's school of simple subjectivism can be supported while there is no need to explicitly refuse the Lachmann/Shackle school of radical subjectivism

(3) Individuals and their will to change and create:

The *homo agens* of Austrian economics is based on common assumptions found in human condition and is thus expected to be universally true. It is hard to deny the Austrian a priori claim that human action, individual differences, and the will to change and create are given in all market actors. People had different endowments with knowledge, resources and capabilities in the past, they presently have different endowments and these conditions will prevail in the future without exogenous change. The will to change and create is expressed in every man's actions, starting with instinctive acts like breathing or more complex acts like thinking and man's de-

²⁷² Cf. Meyer (1997), p. 72.

sire to improve his situation. Even though the properties of the hypothesized *homo agens* are more realistical than those of the neoclassical *homo oeconomicus*, he is still only a condensed version of man. In Austrian economics, the ultimate reason for all action is man's desire to enhance his situation. Man is able to choose his set of ends and apply known and appropriate means to it, but since Mises intentionally delimits praxeology from psychology,²⁷³ Austrian economics does not say anything about the internal processes of forming desires. While this view of man is suitable for the economic analysis of the interplay of market actors and exchange on an abstract level, in-depth attitudinal and motivational studies of human behaviour remain an important tool in marketing. Thus psychological theories that study the forming of ends are necessary supplements to Austrian economics in marketing theory. They start describing, explaining, and predicting human behaviour where Austrian economics stops.

(4) The influence of space and time:

Like all theories, Austrian economics strives for a high reliability across space and time. The influence of space and time is also one of the core assumptions of Austrian economics and occupies a prominent place in the theory. The market process necessarily takes place in a multi-period framework. During the course of time experience, learning, and the alteration of plans occur. In regard to this, reliability across space and time has to be a constituting quality of Austrian economics and is claimed to be valid in Austrian economics because of the fundamental, everlastingly true assumptions about humans and their actions.²⁷⁴ If the theory was reliable only at a given point in time, the market process could not unfold its coordinating powers. The whole theory about the process of market coordination through information would contradict itself and become meaningless. Reliability across space is very important, too. A general marketing theory needs ubiquitous value for marketing phenomena. The existence of marketplaces in ancient Greece that made intensive exchange possible shows that market processes not only take place around the world today but took place in bygone millennia in many places, too. Equilibrating tendencies in market processes are applicable for barter economies, as well. We can assume that market processes happen always and everywhere, where people engage in exchange in competitive markets, i.e. given more than one buyer and seller and free market entry. Yet, the lat-

²⁷³ Cf. Mises (1949), p. 12.

²⁷⁴ Cf. Littlechild (1978), p. 25.

ter condition puts constraints on its applicability. State legislation often restricts market entry to various degrees, be it through patents and trademarks or be it through taxes or tariffs for foreign products. Austrian economics probably works better for markets in developed nations, because the flow of information should be better. We can imagine that the market process will be slower in developing nations with slower spread of information.

(5) Radical ignorance and its influence on the market process:

There are some famous examples of the existence and resolution of radical ignorance. The saga goes that Archimedes surprisingly found a way to unmask a deceitful jeweller, who was suspected to have mixed cheap silver with expensive gold in King Hieron's crown in ancient Sicily. While Archimedes slipped into a bathtub, the so-called 'Archimedes' principle' struck him. It states that different materials have a different density, and thus different displacement of water. Similarly dependent on surprise were Isaac Newton's initial thoughts about the force of gravity. While resting under an apple tree, he recognized an apple falling down to earth. This set off his quest to solve why items on earth fall downwards and why the moon does not do so.²⁷⁵ While Archimedes already thought about his problem, the answer came not by logical deduction or a planned process of research, but by chance to his alert mind. Newton's case goes even further: until he was almost hit by an apple, nobody had thought about gravitation for millennia. There is obviously radical ignorance about an infinite number of things in our universe. But going beyond the idea of passive alertness, influencing the search for knowledge seems possible. There are conditions that foster the generation of knowledge, like money or networks of creative people. While the outcome of research is subject to radical ignorance, the knowledge about the potential to create new knowledge is not. The task of marketing is to resolute ignorance, be it radical or not. Again, the existence of ignorance is a necessary condition for marketing to be purposeful. Without perfect information, marketing has the opportunity to influence potential buyers to decide for possibility A instead of B.

We can regard the assumptions of Austrian economics as quite realistically and thus useful for a field like marketing that tries to find ways to influence the decisions of real people. Two caveats are in order: firstly, the assumption of methodological individualism is responsible for high complexity of the analysis of social wholes. Sec-

²⁷⁵ Cf. Bethell (1987), pp. 6f; 17f.

ondly, the assumptions about subjectivity and the actors' will to change and create can immunize Austrian theory against empirical testing. The latter point will be treated in more detail below (see section 5.1.2 below).

5.1.2 An Assessment of the Hypotheses of Austrian Economics

This section deals with an assessment of the hypotheses that can be derived from Austrian economics, as introduced in section 4.3 (pp. 30f.). The first concern is the universality and conditionality of Austrian economics. We initially regard H_4 as an example. The hypothesis is perfectly compatible with Austrian economics. It was shown before that alert entrepreneurs perceive signals of disequilibrium, especially price-signals. The 'if-component' of H_4 could be altered to $H_{4.1}$: "If opportunities for intertemporal arbitrage exist, then alert entrepreneurs will appear to exploit this opportunity", which is also perfectly compatible with Austrian economics, but less universal. Even less universal would be hypothesis $H_{4.11}$: "If opportunities for intertemporal arbitrage in the market for pig-bellies exist, then alert entrepreneurs will appear to exploit this opportunity". The larger the content of the 'if-component', the smaller will be the hypotheses' universality. It is impossible to measure universality on a cardinal scale, but it is feasible to subsume various phenomena that can be recognized in markets under the hypotheses of Austrian economics. The concepts 'incomplete information', 'markets', 'opportunities' or 'alert entrepreneurs' etc may be further specified and filled with content by the researcher. Thus, the lack of a formalised theoretical body is strength and weakness at the same time. On the one hand, it offers the chance to generate a broad range of hypotheses about various aspects of markets, including marketing. On the other hand such a lack of formalisation contains the danger of arbitrariness. The pretext of Austrian economics is quite unspecific, so a guiding hand in the generation of hypothesis would be helpful to keep in mind the core of Austrianism. There is also a lack of mathematical formulae to express the Austrian model. On the one hand Austrian economics seems straightforward and simple in relation to neoclassicism, because no complicated formal language is needed to explain the mechanics and implications of the theory. Some Austrians even regard mathematical models as exercises in pure logic that offer no new insights because of

their self-evident propositions.²⁷⁶ On the other hand such a formalisation could clarify statements that otherwise need exhaustive explanation.

The broad and universal character of the ‘if-component’ in the basic hypotheses implies a high likelihood of the ‘then-component’. The more conditions are connected to the ‘if-component’ (H_{4.1}, H_{4.11}), the more unlikely will the actual occurrence of the ‘then-component’ become. Now we see if the precision of the given hypotheses could be enhanced, e.g. to H_{4.12}: “If opportunities for arbitrage exist, then alert entrepreneurs will appear within a week on all relevant markets to exploit this opportunity.” Due to the assumptions of Austrian economics, such a limitation is impossible. It is e.g. the existence of radical ignorance that forbids objective knowledge about time and place of the occurrence of an opportunity. A market actor is either alert to the existing profit opportunity and exploits it instantaneously, or he is not alert enough and does not recognize the chance, at all. The assumption of subjectivity prohibits more precise statements on how prices affect individual decisions in case of H₁. Similar to H₄ are the ‘then-components’ of H₂ and H₃ suffering from *ex ante* ignorance. We know that under ignorance the market will be in disequilibrium and that consequently opportunities exist, but there is no information about the degree of disequilibrium or the numbers and whereabouts of potential opportunities. Until those opportunities are alertly recognized, no accurate statements about their properties can be made. The same goes for H₅. It is stated that information dissolves in the course of time, but nothing can be precisely said about the speed of this dissolution or the number and qualities of the imitators. H₆ suffers from the assumptions of methodological individualism, independent will and action, and subjectivism. Experience and learning are very individual phenomena. There may be an average rate of learning and a tendency towards more and more correct decisions, but a statement about single cases seems impossible. While offering a clear implication, H₇ cannot be put more precise, as well. Due to individual decisions the equilibrating tendency may be weaker or stronger, slower or faster. Now it should have become obvious that the ‘then-components’ of Austrian economics hypotheses’ offer only rather vague implications. Austrian economics offers a cause/effect-connection that allows to unambiguously describe and explain the path from disequilibrium to equilibrium through information and learning in a general way, but it is hard to dig deeper into detail. We know that a

²⁷⁶ Cf. Hayek (1937), p. 35; Paqué (1985), p. 426; Yeager (1997), pp. 155f.; Mayer (1998), p. 154.

state of disequilibrium will c.p. be resolved towards equilibrium if free market entry is possible, but not how long it will take and who will be involved when and in which way. Taken together, the high universality of the ‘if-components’ and the mediocre precision of the ‘then-component’ result in limited explanatory power of Austrian economics and limited empirical content.

The logical scope of H₁ is that prices do inform; incompatible would be a misinforming, confusing or neutral role of prices. Compatible with hypothesis H₂ is a state of disequilibrium, an equilibrium state is thus incompatible. H₃ has the logical scope that arbitrage opportunities exist, while a lack of opportunities is incompatible. H₄ has the logical scope that entrepreneurs will appear to profit from opportunities. Situations where no entrepreneurs appear are thus incompatible. H₅ concerns the dissolution of information and appearance of imitation, which is its logical scope. If no information dissolves and no imitation happen, this is incompatible with H₅. H₆ postulates enhanced decision making. Worsened plans with respect to new information are incompatible. Finally, H₇ is compatible with an equilibrating tendency, the notion of status quo or even disequilibrating tendencies is thus incompatible. The logical scope of the hypotheses put forward is always compatible with rather general phenomena, but nonetheless unambiguous. All hypotheses state a very clear implication. The fulfilment of the ‘if-component’ calls for a definite reaction. Due to its generality, the logical scope must be evaluated as being of a medium size, which calls for limited empirical content again.

While a combination of small logical scope and high empirical content is an important goal in theory construction, such hypotheses are particularly subject to the danger of falsification. The attempt to falsify hypotheses depends on the testability of hypotheses in reality through empirical studies. The superstructure of Austrianism, ‘methodological individualism’, which means consciousness, free will and independent individual decisions, has an important implication for the whole complex of scientific research based on it. Austrian economics derives all of its theoretical statements through introspection in order to interpret human action irrespectively of all environmental, accidental, and individual circumstances.²⁷⁷ An important group in Austrian economics, consisting of inter alia Mises, Kirzner, Rizzo, and Rothbard, rejects em-

²⁷⁷ Cf. Kirkpatrick (1983), p. 44.

empirical testing of Austrian hypotheses.²⁷⁸ As it is based on methodological individualism, it is claimed that the entirety of empirical findings picture exclusively historical facts that are valid for a singular case under the given circumstances at that particular place and time. It is denied that empirical findings have any validity for human action in general or for the future, because the complexity of human decisions forbids observation of all relevant facts. Their methodological approach is called ‘Aristotelian’. It sees science as a descriptive enterprise, as a matter of qualitative laws governing the connections between certain essences or categories.²⁷⁹ This anti-historicism has become the harshest criticism of Austrian economics.²⁸⁰ On the other hand, “[i]t is safe to say that no two Austrians have ever completely agreed on methodology [...]”.²⁸¹ It is Hayek who defends a more moderate methodological ground within the Austrian school. Although he agrees with the scholars mentioned above on the belief that no singular outcome can be predicted and thus empirically tested, he claims that empirical methods are useable. They allow finding and predicting structures, patterns and abstract order in the market process.²⁸² Rizzo admits that statistical regularities are useful as a starting point for a theoretical investigation, insofar as they raise questions scientists could address themselves to.²⁸³ Until now, there is no known record of a falsification of Austrian economics. Unfortunately, this statement is troublesome. Theoreticians may construct hypotheses about market behaviour, e.g. about the equilibrating tendency, but two innate factors of Austrian economics are an obstacle to testing. If the postulated tendency towards equilibrium in a specified market is not found, the hypothesis or theory would normally be said to be falsified. In the Austrian framework, however, ad hoc explanations for contradictory findings are readily available. At first, there is the assumption about market actors who subjectively choose their ends in the market process. If natural or artificial barriers to entry into the market can be ruled out, there may have been a spontaneous and subjective change in preferences that disturbed the whole market process. The second possibility for unexpected findings in empirical research are radical ignorance that hindered entrepreneurs to find a profitable opportunity, or vice versa the resolution of ignorance that led to surprising innovations of entrepreneurs, which can always interfere with testing

²⁷⁸ Cf. Mises (1949), pp. 30-32; Kirzner (1976), p. 43; Rizzo (1978), p. 53; Rothbard (1976), p. 28.

²⁷⁹ Cf. Smith (1994), p. 33.

²⁸⁰ Cf. Rese (2000), p. 216; Rosen (1997), pp. 147f.; Reekie/Savitt (1982), p. 62.

²⁸¹ Littlechild (1978), p. 22.

²⁸² Cf. Hayek (1994), p. 251; Hayek (1964), pp. 338; 343.

²⁸³ Cf. Rizzo (1978), p. 52.

and are thus an obstacle for the development of clear statements and predictions based on Austrian economics.²⁸⁴ The caveat that has to be mentioned is that the stated hypotheses are valid only *c.p.*, i.e. if no unforeseen change disrupts the process that possibly makes it start all over again. Under the given assumptions and without the *ceteris paribus* clause, Austrian economics is immunized and not falsifiable in a Popperian sense anymore. In the social sciences, the deduction of hypotheses through introspection and logic does not justify untestability. Theories that immunize themselves are normally dismissed as sensible foundations of science. Marketing – and science in general – should not hide behind a theory that is not testable.²⁸⁵ Austrian economics, however, has had many critics during its history but was successfully defended by its adherents for over 130 years now and is as vital as never before. Empirical tests are carried out against the will and intentions of influential Austrian scholars, hoping to find support for general statements of Austrian economics. Even though the theory is immunized against contradictions, empirical findings based on Austrian theory are compatible with regular Austrian statements so far, without having to rely on *ad hoc* immunization strategies. Shane e.g., using the case-study-method, found empirical support for the hypothesis that entrepreneurs who differ in their initial resource and knowledge endowment will be alert to different possibilities to profit from a given technology. A particular entrepreneur is alert to profit opportunities that someone else does not see, because he possesses idiosyncratic knowledge.²⁸⁶ Zaheer and Zaheer conducted a study about profitability in the international banking sector. They found out that alertness to opportunities in disequilibrium exists, reveals profitable opportunities, and is an important factor in competition with other banks.²⁸⁷ Rese found explicative powers of Austrian economics for the behaviour of strategic groups in markets where high degrees of ignorance prevail.²⁸⁸ These findings are encouraging. Austrian theory seems to work at least in an environment in which no sudden major changes take place during the scrutinized period, but further elaboration would be helpful. It would also help to dismiss the dogmatic anti-historicism of Austrian economics and follow a Hayekian train of thought. It should be possible to assume that there are general, empirically testable patterns in the mar-

²⁸⁴ Cf. Rese (2000), p. 215.

²⁸⁵ Cf. Bagozzi (1984), p. 27.

²⁸⁶ Cf. Shane (2000), p. 449.

²⁸⁷ Cf. Zaheer/Zaheer (1997).

²⁸⁸ Cf. Rese (2000).

ket process – or ultimately human behaviour – that are more or less stable over multiple periods on an average across a large population. If a sample of a hundred people is regarded today who like the colour red best, it can be surely predicted that the overwhelming majority will still like red best tomorrow. Learning based on experience is an empirical occupation. If empirical findings cannot be generalized because all observations are valid for a singular case only, systematic learning about advantageous opportunities in the marketplace and consequently the equilibrating tendencies of the market process become impossible. A buyer who finds an opportunity at a favourable price must always perceive it as a solitary opportunity, depending on the particular circumstances of time and place that may or may not be repeated at a later point in time or another place, if systematic learning is impossible. A seller is subject to the same uncertainty. An exchange partner who paid a favourable price may offer the same amount, a higher amount or a smaller amount under slightly different circumstances for the same good or service. Knowledge that was gained once cannot necessarily be assumed to be valid for the future. It follows that it is absolutely necessary that experience and knowledge gained today are at least roughly applicable to tomorrow's situation; else all learning is a Sisyphean task. It is true that human beings in their complexity will be never understood completely. But it is also true that certain variables in human behaviour are quite stable over time or follow a rather evolutionary than revolutionary change. On these premises, generalizations and predictions about the future are possible. It would be helpful to find conditions that influence the occurrence of surprises and changes in preferences to support such generalizations and predictions. At the moment this seems utopian, but if such conditions were to be found and surprising changes could be isolated from the rest of the market process, the problem of immunization could be healed and hypotheses independent of unpredictable events could be constructed.²⁸⁹ Other interesting questions yet to be answered are the conditions under which entrepreneurial alertness is fostered,²⁹⁰ e.g. if companies as a conglomerate of knowledge have an 'alertness advantage' over individuals. Does alertness determine the optimal firm size?²⁹¹ Research and development departments in companies could be organized according to such findings. Furthermore,

²⁸⁹ Cf. Rese (2000), p. 216.

²⁹⁰ Cf. Ricketts (1992), p. 82.

²⁹¹ Ioannides attempts to explain the emergence of companies within Austrian Economics as the product of interpersonal efficiency in the competitive market process. The maintenance of the company depends on constant entrepreneurial success. Cf. Ioannides (1999), pp. 85-95.

conditions that influence the dissemination of information or other conditions that accelerate equilibrating tendencies are interesting for marketing. Marketing managers who plan to imitate a particular offer could use such knowledge in order to hasten their effort of imitation, while innovators²⁹² could, on the contrary, think of ways to prolong their monopolistic status in competition through slowing down the diffusion of knowledge.

5.1.3 The ‘Triangular Problem’ in Austrian Economics

Despite the aforementioned difficulties concerning the generality of Austrian hypothesizing and possibilities of ad-hoc immunization, there are reasons for accepting Austrian economics as a basis for hypothesis generation in marketing in the present state of the world. The difficulties should naturally be borne in mind until further research has resolved the problems and more evidence is found that supports Austrian economics. Until then the lack of testability puts up a problem concerning the truth of the theory. However, Austrian economics should be temporally accepted since hypotheses derived from Austrian economics offer an accurate picture of the equilibrating processes that take place and they could be verified in successful empirical trials so far. It was suggested in section 5.1.2 (pp. 34-40) that Austrian economics has only limited empirical content. Its strength and purpose is not to explain a singular event in the market, but it is a complete theory of the market process. In the field of economics and especially for marketing, Austrian economics is a novel theory. Admittedly, Austrian economics looks back on a long and changeable history, but the hypotheses stemming from its body of work were and are genuinely original in comparison to other existing theories. There is no other theory that regards market coordination as thorough a process as Austrian economics. It is not only valid at different places, but especially across time due to its emphasis on dynamic processes. Austrian economics allows the formulation of completely different implications, especially in comparison to its microeconomic competitor of neoclassicism. In regard to the triangle of the conflicting demands of truth, empirical content and novelty, there is a weakness on the ‘truth-edge’, and another one on the ‘empirical content-edge’ due to the limited precision of the hypothesis of Austrian economics, but a strong point on the ‘novelty-

²⁹² Innovators are those entrepreneurs or firms that are the first to commercialize a new product or process in the market. Cf. Teece (1987), p. 185.

edge'. The weaknesses, though, are not grave enough to call Austrian economics a 'fantastic speculation', 'magic' or 'superstition'.

5.2 Application of Austrian Economics as a Marketing Theory

Now that the epistemological strength and weaknesses have been pointed out, potential applications of Austrian economics will be under scrutiny. Since Austrian economics was originally conceptualized as an economic theory and not as a marketing theory, the congruence of marketing and Austrian economics has to be established. Does the scope of Austrian economics overlap with that of marketing theory? Is the theoretical spotlight pointing on marketing phenomena? The first impression of Austrianism is highly valuable for marketing theory: profiting from economic activity is possible.

5.2.1 Description and Explanation of Reality

Since it is hard to draw the line between description and explanation, these two functions of a theory will be treated simultaneously. Austrian economics in its present state is directed towards thorough description.²⁹³ Starting from the phenomenon of a disequilibrium market the whole process that resolves the incompatibility of plans and expectations towards equilibrium is described. The description includes time, knowledge, entrepreneurs, etc. The applicability as a marketing theory will be tested by seeing if Austrian economics is able to account for Hunt's four basic explananda for marketing theory (see section 2.1, p. 5).

(1) The behaviour of buyers directed at accomplishing exchanges:

Austrian economics and marketing share an important understanding: Individual buyers engage in exchanges of resources to be better off afterwards. Starting from a condition that could be described with the behaviouristic state of cognitive dissonance²⁹⁴ between the perception of the actual state and expectations about a preferable, imagined state, the individual engages in certain activities that are supposed to peak in an exchange. An exchange or a number of consecutive exchanges is the culmination of marketing activities. In the acts of buying and selling resources change ownership and profits can be realised. Both buyers and sellers are interested in exchanges, because their respective situation is supposed to be enhanced afterwards. The parties that en-

²⁹³ Cf. Fritz (1990), p. 496; Rese (2000), p. 215.

²⁹⁴ Cf. Homburg/Bruhn (2000), p. 14.

engage in an exchange must fulfil the condition of offering the partner the best opportunity known and available. The element of time in Austrian economics explains why learning takes place in the period between the recognition of a problem, the exchange, and subsequent exchanges. The buyer has an amount of experience about goods and services that may solve his problem, and he may learn of other possibilities in the course of the market process. Since the 'Austrian buyer' has no perfect information, his evoked set is limited. He is alert to and consequently considers only a limited number of possible solutions. The decision process between different feasible outcomes is strictly subjective. Consumers are not exclusively sensitive to prices, but the recognition of the consumers' economizing behaviour accounts for the fact that they choose the cheapest item from a set of homogeneous goods. Actors with constrained knowledge consider qualitative and other aspects of the offers as well, the result being a strictly subjective willingness to pay for goods and services.

The Austrian framework is also concerned with sudden changes in customer preferences. Changes are explained through the independent human mind that has its own will and power to choose goals. Excellent examples of sudden changes that affect business are found in the fashion- and toy-industries. A product, brand, label or designer that was very fashionable or a 'must-have' yesterday might be totally *démodé* today. Who remembers all the Tamagotchis, Teletubbies and Pokemons that no child could live without a few years ago, but which live in oblivion now? In the course of time, dependant on learning and experience, trends change and customers today might not be willing to pay a cent for something they placed a high value on yesterday. The view that Austrian economics has of market actors who engage in buying is close to actual behaviour. It accounts for many facets of human behaviour.

(2) The behaviour of sellers directed at accomplishing exchanges:

Two kinds of sellers must be distinguished in the Austrian framework. At first, there are sellers who are resource owners by natural endowment or earlier alertness. If they are not alert to opportunities because they suffer from too much ignorance or are simply not courageous enough to grasp an opportunity, they will not make a profit. This class of sellers is not very interesting for marketing. The interesting personification of a seller in Austrian economics is the second class of people, who Kirzner called entrepreneurs. It is the entrepreneur who generates a profit from buying and selling. It is justified to say that his qualities and his coordinating activities in markets that are

subject to ignorance are at the centre of Austrian economics. Entrepreneurs are driven by the search for profitable opportunities. Profitable opportunities vitally depend on customer desires and wishes, because it is the final user of a good or service who determines its price in affluent societies. The realization that it is the customer who decides about winners and losers in the market process puts Austrian economics very close to marketing. Successful entrepreneurial activity in the marketplace depends on fulfilling customer desires. A market segmentation that addresses market actors with different tastes and preferences is facilitated. Sellers have to produce the right product or service at a competitive price, make it known via informational means and have it sold at a place the buyer is willing to visit. Austrian economics thus describes and explains the employment of the four classical marketing-mix instruments (4 P's). Austrian theory is a truly marketing-friendly theory because it integrates the costs for the creation of information into the manufacturing costs of the associated product.²⁹⁵

The entrepreneur in the Austrian framework as someone who is always alert to profitable opportunities is not necessarily restricted to exchanges of consumer goods or of commercial exchanges in general. The applicability or rather the descriptive and explanative powers of the Austrian entrepreneur in resource-markets or intermediate-good-markets are a matter of course. The addressees of the sellers' marketing strategy are individuals in the end. Individuals in their function as employees of a company are not directly trying to subjectively maximize their own utility, but that of their respective companies, but as human beings they more or less show the same behaviour like consumers. Austrian economics is theoretically applicable for exchanges within organizations, if the internal organisation employs signals like artificial transfer-prices. If the transfer-prices have a correct value or are intentionally set to promote specific goals and are not misleading due to ignorance, they will unfold the same processes as in external markets with internal entrepreneurs driving prices to an equilibrium level. Several factories of a car-manufacturing enterprise could e.g. compete for the production of a new car. Within an organization, though, it is difficult to imagine that there are no rules prohibiting the free entry of all departments into all kinds of activities, e.g. of the marketing department into accounting, if they think that they can do it cheaper and better. It is also difficult to fully embrace the entrepreneur in non-profit organizations. Austrian economics states that human actors' ends are not neces-

²⁹⁵ Cf. Kirzner (1973), pp. 145f.

sarily solely advanced by making profits or buying goods and services to fulfil a material need. Actors' individuality accounts for people who feel better by helping other people, animals, the environment, or by enjoying religious feelings. Entrepreneurs (sellers) can create or shape charitable offers suited to customer (follower/worshipper) desires in order to maximize donations, but the idea of the informational role of prices and of the process of competition that drives down prices becomes irrelevant. Donations are voluntarily and hardly comparable to the price of a commercial good or service. It is hard to believe that a faithful Catholic switches to Protestantism because the expected donations are lower. The donator may be interested in an efficient use of his donations, but the amount (or price) he is willing to donate depends exclusively on other factors. It follows that Austrian economics is best applied for commercial exchanges.

Austrian economics permits that marketing takes time. Some measures of the marketing strategy are conducted simultaneous, but it is often a chronological process of planning, coordinating and executing. Marketing is also preparing the exchange transaction. Its role is to make potential buyers aware of the desirable features of a good or service. Potential buyers are actively working towards the exchange of resources after their indoctrination via marketing means. This notion is impossible in static theories. Sellers may conduct a certain strategy and measure its impact over time. Sales numbers and data are a constant test of hypotheses about the attractiveness of their offer. Significant changes in demand mean either that customer preferences changed or that new competitors appeared in the marketplace. Entrepreneur-marketers may compare their strategy to competing ones. They can learn from earlier mistakes and revise their strategy. This dynamic perception of time is also necessary to account for relationship marketing. Sellers can positively influence the subjective perception of buyers in earlier periods in order to gain an advantage in later periods, since transactions are not independent. Given perfect information and hence no transaction costs whatsoever, all buyers and sellers would engage only in independent transactions. In Austrian economics, relationships that reduce ignorance and insecurity are valuable.

(3) The institutional framework directed at accomplishing and/or facilitating exchanges:

Real institutions human beings created to accomplish and facilitate exchange are well explained in Austrian theory. The first one is the market. In a market, buyer and seller or demander and supplier meet in order to exchange their resources, which will expectedly make both better off afterwards. Markets may consist of two parties, if subjectivity predominates and the alertness of both parties is restricted. They may consist of multiple parties, if more than one seller made the potential buyers aware of his offer and/or if more than one buyer shows interest in the available means. Only here can the equilibrating powers of competition unfold. Nowadays markets sometimes consist of almost the entire world, because modern information technology like the internet offers new and cheap opportunities of communication between buyers and sellers. A market is thus not a fixed territorial place, but the variable result of informational activities on both sides of the buyer-seller dichotomy. The second institution, money, facilitates exchange by enhancing the signalling value of prices. A common denominator for all goods and services, like money, makes the comparison of prices much easier compared to a barter economy. With the term of ‘institution’ Hunt also refers to intermediaries in the market process, such as wholesalers, retailers and agents engaged in transportation, warehousing, advertising, or market research.²⁹⁶ The first two are entrepreneurs themselves. They take title in goods and alertly try to exploit opportunities to better fulfil customer desires for distribution. The other groups are auxiliary forces in the market process. They aid entrepreneurs to achieve an optimal marketing mix of information, time, place, product properties, and price. The fourth institution is the system of laws of a state and the property rights the laws protect. Both are not explicitly explained in the core of Austrian economics. They are exogenously given, but play an important role in securing free market entry and a voluntary and orderly exchange of resources. A totally free market entry is utopian in the present state of the world. Austrian competition is hindered through various laws, like patent legislation and bureaucratic obstacles. One country that switched from central planning of the economy to a system with freer market entry and private property rights is China. It is an example of the vast success of private entrepreneurship in facilitating exchanges. The move to economic liberalization started late in the year

²⁹⁶ Cf. Hunt (1983), p. 14.

1978 and resulted in “[...] two decades of sustained high economic growth rates of between 10 and 11 percent annually compounded”.²⁹⁷

(4) Consequences on society of the behaviour of the buyer, seller, and the institutional framework directed at accomplishing and/or facilitating exchanges:

Comparably free market entry and stable institutions have led to the development of economies in the Western hemisphere as we know them today. Private entrepreneurship that appreciated consumer sovereignty has resulted in our affluent society and has led to a vast number of choices from which consumers may satisfy their diversified needs. Sometimes the consumers’ power led to an availability of certain goods and services anytime and everywhere. Consumers in affluent societies are subject to a constant stream of information. Entrepreneurs try to alert consumers to their opportunity and convince them that their offer is the best. Mises stated in 1949 that advertising gets continuously shriller and displays the bad taste of the public (see section 4.2.3, p. 29). For someone living in the 21st century, advertising from the 1940s and 1950s appears reserved and boring, while present strategies of gaining attention indeed seem to have gotten more aggressive. This is e.g. reflected in the famous advertising campaign of Benetton in the 1990s, which showed the bloody garments of civil-war victims, a death-row inmate and people suffering from HIV. However, sometimes loud advertising campaigns do not work. The success of discount supermarkets shows that customers do not always perceive the subjective superior value of heavily advertised and branded products. The lower price of private brand goods is often preferred to the subjectively higher esteem of branded goods. Here we are in the mainstream of Austrian economics. It is possible to recognize price- and non-price-competition and to explain ex post how and why it occurs. It is impossible, though, to predict ex ante which one is more important in the decision process of market actors.

The economic phenomenon of the globalization of production with all its influences on society is connected to the competition for the lowest price. Austrian economics offers a perfect explanation for “[...] the sourcing of goods and services from locations around the globe to take advantage of national differences in the cost and quality of factors of production (such as labour, energy, land, and capital). By doing this, companies hope to lower their overall cost structure and/or improve the quality or functionality of their product offer, thereby allowing them to compete more effec-

²⁹⁷ Hill (2003), p. 208.

tively”.²⁹⁸ After the resolution of the conflict between the eastern communist bloc and the western democratic bloc various new opportunities arose. In many former Communist countries and in countries that were outside the western trade system the institutional framework changed towards a more liberal economic system, that is more closely connected to the west. On their eternal quest to offer attractive opportunities to the consumer – either through lower prices or better quality for their goods and services – alert entrepreneurs started to produce in reformed countries if labour was cheaper than in Western countries. Meanwhile, the production of various kinds of goods and services has moved from developed countries to developing countries, a movement that started with the production of labour-intensive goods and went on to software programming, accounting and tax calculations. A classic example is the production of colour-TV-sets, originally an innovation from the United States that was later imitated by entrepreneurs in Japan and Germany. Even later the production of TV-sets moved to South Korea, and nowadays to China. In the course of this movement, production costs were continuously sinking and consumer prices were sinking strongly as well compared to the average income of workers in the Western hemisphere. Prices for many goods could not be as cheap as they are, if it was not for entrepreneurs who saw those opportunities. Many entrepreneurs (or entrepreneurial companies) are selling very profitably, because they still have a temporary monopoly on differentiated goods and services or because they can produce more cheaply than their competitors. Some are alertly exploiting the differential between wages in the developed countries and developing countries. Textile workers in various Chinese factories e.g. got paid between \$0.13 and \$0.35 per hour for up to 93-hour working weeks in 1998, compared to \$10 and \$18.50 per hour in 1996 in the United States and Germany, respectively.²⁹⁹ Hayek’s insight that those will produce something who are able to craft it for the lowest price is verified. The market process may not yet have reached a state of equilibrium. Workers in Africa are potentially accepting even lower wages, but problems in regard to political and social stability and property rights hinder the exploitation of such opportunities. Another societal phenomenon is explicable: product piracy, i.e. the illegal imitation and selling of products. If laws are not enforced strongly enough, pirate-entrepreneurs perceive a chance to participate from the informational expenditures other entrepreneurs incurred.

²⁹⁸ Hill (2003), p. 7.

²⁹⁹ Cf. Klein (2000), pp. 212; 474.

Austrian economics has strong descriptive and explicative powers for all aspects of marketing theory. The first criterion of Hempel and Oppenheim (see section 3.3.1, p. 17) is fulfilled, too. It is possible to logically deduct a number of phenomena from Austrian economics. The law needed is given by the elaboration of Austrian economics based on its various assumptions. Empirical content and truth of Austrian economics have been evaluated before and found to be of a restricted degree. The demand of the independence of explanans and explanandum is, of course, problematic due to the immunization tendencies of Austrian economics.

5.2.2 Prediction of Incidents and Technological Use

The inherent complexity of human actors, the economic system and a lack of knowledge is problematic for the predictive qualities of Austrian economics. It is impossible to control the secondary conditions about human preferences and about the dissolution of radical ignorance, which is responsible for innovations. Kirkpatrick defends the point of view that Austrian economics is incapable of generating predictions about the future. He pragmatically suggests that marketing based on Austrian economics should use consumer psychology and extrapolations of market research data as auxiliary methods in order to gain speculative insight into the future.³⁰⁰ It is due to this weakness in prediction that Austrian economics could not take the position in economic and marketing science it deserves, if we take a look at its strong descriptive powers. The possibility of predicting general patterns of the market process is analogous to the hypotheses set up in section 4.3 (see pp. 31f.). If we accept the hypotheses H₁ to H₇ as law-like generalizations, we can deduct the following prognoses from a tautological transformation:

P₁: Prices serve as a means of communicating information.

P₂: Markets suffering from ignorance will be in disequilibrium.

P₃: Opportunities for arbitrage exist in a market that is in disequilibrium.

P₄: Alert entrepreneurs appear to exploit opportunities.

P₅: Information about entrepreneurial activities spreads in the market in the course of time and attracts imitators.

³⁰⁰ Cf. Kirkpatrick (1983), p. 48.

P₆: Experience and learning result in enhanced decision-making and plans that mutually fit better.

P₇: An equilibrating tendency begins.

Using these predictions allows us to say that alert entrepreneurs will perceive price signals and try to find profit opportunities in disequilibrium markets (P₁, P₂, P₃, P₄). The assumptions of Austrian economics are unfortunately an obstacle to the control of the secondary conditions. Due to radical ignorance, the independent human mind and subjectivism we are not able to predict when the entrepreneurs will appear, how many there are, where to find the opportunities, and the value of the opportunities. Innovators can be successful – at least for a certain period of time – but they can also mistake consumer desires and incur losses. What we can surely say is that success in the market depends on the correct anticipation of customer needs and selling the accordingly designed item for a competitive price. The dissolution of information that will inevitably happen in the marketplace will sooner or later attract competition (P₅). If the proliferation of goods and services continues it is possible to predict that advertisements will become even more shrill and noisy, given constant tastes and capabilities of consumers, because offers must be made known to customers. Learning and experience in the course of time will enhance the actors' decisions and start an equilibrating market process (P₆, P₇). Entrepreneurs must be aware of imitators and be prepared to handle a continuous compulsion to innovate. Teece holds the caveat that, although Austrian economics predicts that innovative entrepreneurs are most successful, it is often an imitator who reaps the greatest benefits.³⁰¹ This notion is certainly true but can be explained because there is more to economic success than the right product: the right marketing-mix.

5.2.3 Austrian Economics as a Device for Criticism

Austrian economics emphasises the superior transmission of information in markets, which results in better fulfilment of consumer needs as opposed to centralised planning, especially in Communist societies.³⁰² History showed that Austrians were right in the 'socialist calculation debate' with their claim that central planners do not have all the relevant knowledge to calculate equilibrium prices and provide consumers with an optimal amount of goods and services. Whereas institutions are accepted for

³⁰¹ Cf. Teece (1987), p. 185.

³⁰² Cf. Prychitko (1994b), p. 226.

the functioning of the market process, government interventions are criticized, because they enhance the market process only by chance. Subjective governmental interference into the forces of the market process can never be superior to the vast amount of market knowledge and will thus cause only additional bias. The banning of tobacco advertising in cinemas and on TV in the European Union e.g. biases the market process in the relevant market. Differentiated or cheaper offers cannot be advertised effectively anymore and the flow of information is hindered. The overall effect on the abuse of tobacco products is dubious. An implication of this governmental intervention is the fact that the current position of incumbent tobacco products is fortified. The same criticism is true for interventions in other fields: Given a set of rules that secure property rights and free market exchange, it would be economically efficient to have as few interventions as possible. However, Austrian economics does not make normative statements about the moral and ethical value of interventions.

Austrian economics is often used to criticize neoclassicism on the ground of the more realistic assumptions of Austrianism. Neoclassicism does not account for any facet of marketing because of the assumption of perfect knowledge and actors who maximize given goals in the highly unrealistic state of perfect competition.³⁰³ In the neoclassic equilibrium framework all profits have been competed away and there are no profits to be reaped anymore. However, both schools have common understandings. Many Austrians regard equilibrium as the final stage of the coordination process in a distant future. It is a state in which all signals are correctly perceived in such a manner that all plans and decisions of market actors align. This is exactly the basic tenet of neoclassicism: complete information is crucial for equilibrium. Some ideas of neoclassicism could be integrated into the Austrian framework on this condition. Connected to the criticism of missing realism in neoclassic theory is the criticism of a school of strategy called ‘Industrial organisation’ (IO), which is based on neoclassicism. Austrian scholars claim that IO relies on an insufficient theoretical structure, is ignorant to change due to its static equilibrium thinking and does not explain entrepreneurial efforts to innovate.³⁰⁴ Profits do not depend on successful differentiation from competition but on the exertion of monopoly power.³⁰⁵ A consistency of another theory with Austrian economics does, in contrast to IO, exist. Hunt claims that the ‘Resource ad-

³⁰³ Cf. Block/Barnett II/Wood (2002), pp. 51f.

³⁰⁴ Cf. Jacobson (1992), pp. 783-785.

³⁰⁵ Cf. Bain (1951), pp. 294f.

vantage theory' is consistent with Austrian economics and could provide the foundations for developing an Austrian theory of competition.³⁰⁶ A superficial comparison shows that there are common grounds of Austrian economics and NIE, since both are interested in the problems and effects of ignorance and the importance of information. Furthermore, psychological research could prove fruitful to elaborate on the market actors' subjectivity and decision processes.³⁰⁷ Theories like the confirmation/disconfirmation-paradigm³⁰⁸ and the phenomenon of cognitive dissonance³⁰⁹ resemble and seem consistent with the problem-solving behaviour of the Austrian decider. Another potential for the integration of theoretical knowledge into Austrian economics is the Bass Model mentioned in section 2.2 (pp. 7f.). The diffusion of innovative products depends on the availability of knowledge about them. It is possible to perceive the Bass Model as the empirical proof for certain Austrian claims and it can be very well related to Austrian economics. Knowledge about offers, e.g. spread through advertising effort, alerts customers of a new and advantageous opportunity. Since the diffusion of information in a market grows over time, demand for such products rises. Later, new information will slowly but steadily overlap with old information after the introduction of the next innovation and deduct demand from the old offer, so that the overall demand for the old offer declines again.

5.3 Implications of Austrian Economics for Influencing Transaction Processes: The Entrepreneur as the Marketing-Manager

The attempt to derive implications from Austrian economics to influence transaction processes confronts us again with the problems of immunization and unpredictability of single events. The missing property of unambiguous prediction of Austrian economics is consistent with the real world.³¹⁰ The outcome of marketing activities is uncertain and marketers speculate about future events, too. Since peoples' preferences and tastes continuously change,³¹¹ most product innovations – even if they have been tried in a market test – do not succeed financially. Still, marketing activities are essential for the functioning of the market process. The marketing-task of the entrepreneur is to employ all tools of regular marketing-management to facilitate exchanges, be-

³⁰⁶ Cf. Hunt (2002), p. 249.

³⁰⁷ Cf. Albert (1988), p. 598.

³⁰⁸ Cf. Giering (2000), p. 8.

³⁰⁹ Cf. Homburg/Bruhn (2000), p. 14.

³¹⁰ Cf. Mises (1949), p. 106.

³¹¹ Cf. Reekie/Savitt (1982), p. 57.

cause certain conditions have to be fulfilled before an exchange takes place. Making use of the classical marketing-mix of product-quality, pricing policy, distribution and promotional activities is a clear implication of Austrian economics. All of these variables will influence transaction processes.

Meyer claims that the entrepreneurial role in Austrian economics is identical to market-oriented business leadership as understood in modern marketing.³¹² The picture of marketing that was put forward in the three definitions by Meffert, the AMA, and Kotler/Bliemel (see section 2.1, p. 3) has as well striking similarities with the Austrian entrepreneur. Austrian theorists and marketing theorists share the common understanding that customer satisfaction is a necessity for successful exchanges. Both entrepreneur and the manager of the marketing function want to generate exchanges of resources. If either the entrepreneur or the marketing-manager mistakes or ignores the primacy of the consumer, he will not sell enough and be driven out of the market. There is also an empirical difference between the Austrian entrepreneur and the marketing-manager. Many people occupied with marketing do not work independently. The stereotypical marketing-manager is an employee of a big consumer-goods company. Questions arise if these managers are not alert enough to work on their own account or which advantages they enjoy within an organization.

5.3.1 The Pricing Policy in the Competitive Environment

The market actors' economizing behaviour suggests that the first instrument of the classical marketing mix, price, is the crucial sales argument for homogeneous goods. Buyers will choose the least expensive out of a number of identical offers. Price signals that are statements about a shortage or an excess supply of goods or services and information that is available in the marketplace must be correctly perceived, processed and evaluated. Marketing-managers can find out if a competitor reaps profits with his offer, if signals are correctly perceived and interpreted. The sellers will take the chance to imitate a successful idea of competing entrepreneurs whenever and wherever possible in order to participate from profits. Various sellers who sell a homogeneous good have to compete on price until all profit opportunities have disappeared. Being successful in such an environment implies being the seller with the lowest price. This implies an essential informational task for all market participants,

³¹² Cf. Meyer (1997), p. 67; cf. also Kirkpatrick (1983), p. 49.

but especially for the marketing-manager or the entrepreneur. All producers of homogeneous goods or services, whether it is the original inventor or an imitator, have to be alert to superior production techniques to fabricate cheaper than competition. To employ the most advanced or cheapest production technique is the only way that sellers can stay ahead of competition in a market for homogeneous goods. This implies e.g. that the globalization of production and the movement of production sites to developing countries needs to and will continue. We can expect the end of that movement in a distant future, if all wages for workers who have the same skills in producing a good or service have been equalized on the whole planet (given free market entry). The customers will profit from the search for better production techniques due to increased supplies at cheaper prices because of lower production costs. Marketing-driven companies will move the relevant markets toward equilibrium, but the final resolution of disequilibrium towards the neoclassic idea of market clearance seems to be an empirical exception.³¹³ An implication of using prices in terms of money instead of cows, bushels of wheat and pieces of pottery in a barter-economy, or enhanced spreading of information in general, is that competition will c.p. be fiercer and the equilibrating processes will be faster on average.

5.3.2 The Product Policy: Adapting to Customer Preferences

The most important insight of Austrian economics that is relevant to marketing is that the customer is the most powerful actor in the market process and the centrepiece of entrepreneurial endeavour. Transactions take place only if the customer perceives additional benefit compared to a competing solution or to no exchange at all. This is good news for consumers, because entrepreneurs need to do, produce, and sell almost everything that fulfils consumers' desires and needs. Entrepreneurs must be aware that they can only be profitable, if they are committed to constant alertness and consumer service. The second marketing-mix instrument is thus product quality. The differentiation of product qualities is the only way of escaping from fierce price-competition and being profitable.

Market actors seem to have an infinite desire for new and differentiated products to fulfil their individual needs. Sometimes customers formulate such desires, but often their radical ignorance hinders them to think of things that do not yet exist. Active

³¹³ Cf. Reekie/Savitt (1982), p. 55.

and passive search for solutions to customer problems both buyers and sellers are still ignorant about is necessary to outpace competitors. Austrian economics claims that entrepreneurs must be sensitive to such explicit or implicit requests since differentiation allows profits to be reaped at least for a limited period because of the monopolistic position. Both the entrepreneur and/or the marketing-manager are forced to accept losses as well as profits in this attempt. They are subject to the same constraints on human rationality (subjectivism, ignorance) like potential buyers. As human beings their decisions are sometimes right and sometimes wrong, since the future is unknown. A mistaken perception of market information causes losses. Entrepreneurs whose success is below average will be forced to leave the market sooner or later. Resources will flow toward entrepreneurs who correctly perceive consumers' desires and only those entrepreneurs who push the market process towards a higher equilibrium will survive in the market process.³¹⁴ The people who are currently working in the field of marketing are successful enough in the fulfilment of consumer desires to keep the majority of the world population from entering into entrepreneurial activities.

Another implication of Austrian economics is that the longer the period of monopolistic power in a market, the larger will be the profit of the monopolist. Thus, trying to prolong the duration of a monopoly is an important goal for marketing in the market process. A recommendation that is incompatible with the ideals of Austrianism for keeping a monopolistic position could be to lobby lawmakers to prohibit entry of competitors into the market in question. Austrian economics accepts monopolies, as long as they stem from competition and free market entry is possible. The competitive way for entrepreneurs to stay ahead of competition is to find or develop a resource or skill crucial for production that cannot be easily imitated. This may be the sole access to a natural resource like oil or gold, or it may be the access to the human resources of people with unique skills or non-transferable knowledge, or knowing a formula like the secret recipe of Coca Cola, or owning the property rights of a patent that prohibits the imitation of something particular. None of these possibilities promises profits forever, though. An oil well may run dry, or a gold mine may be exhausted. A human being may lose his unique skills or knowledge, a secret formula can be stolen and copied and a patent expires after a certain period of time. Furthermore, tastes, prefer-

³¹⁴ Cf. Jacobson (1992), p. 788.

ences and technology change. These inevitable changes imply an infinite number of disequilibria, which is equal to a constant stream of profit opportunities on the one hand, but on the other hand the goods and services under protection may not be sought after anymore, which implies that flexibility and constant openness to change and innovation are crucial for success in the marketplace.

Current consumer criticism claiming that conformity of style and taste etc (see section 2.3, p. 9) are the result of mass-marketing is supposed to be resolved in Austrian theory, as long as a further differentiation of those items is profitable. Global branding and global uniformity of product- and service-offers is limited by the will of consumers to accept and pay for those goods and services. It is the homogeneous preference of the consumers for the food of McDonald's that makes McDonald's sell the same food on a global scale. If everybody is free to choose, the reproach to marketing as being the source of uniformity is inappropriate, because the customer is the source of uniformity. Customers with similar preferences will thus compel entrepreneurs to sell homogeneous products. National, regional and rarely even individual differences in taste make the market process find another, more differentiated solution to customers' problems, if the entrepreneur can gain profit in fulfilling more diverse desires. The degree of individualization of transaction processes that is still profitable will be found out in the course of the market process, because a trade-off between increased differentiation on the one hand and increased production costs (like a lack of economies of scale, reduced effects of learning, increased informational desires) on the other hand will prevail. Learning and gaining experience does not only take place in regard to the product, but the distribution and communication strategy are affected, as well. Different customers respond to different informational means and are aware of goods and services at different locations.

5.3.3 The Communication Policy: Selling Gas-Which-Is-Known-About

Entrepreneurs or marketing-managers in the market process do not only perceive information to find out about opportunities and set prices, but they must employ an active means of influencing the market process on their own: deliberately sending information to alert the buyers about existing opportunities, because exchanges can only take place if the two potential parties to the exchange know of each other's offer. Kirzner claims that the owner of a gas station must not simply offer gas. If nobody recognizes the gas-station, not a single gallon of gas will be sold. His task is "[...] to

supply gas-which-is-known-about [...]”.³¹⁵ Even if an opportunity has an advantageous price or superior qualities, the ignorant buyer will not select it because of his radical ignorance. To resolve this ignorance, the third instrument of the marketing-mix – the advertising or, more generally, the communication strategy – is used. It is explicitly mentioned in Austrian economics, especially in the works of Mises and Kirzner. It is an important means of spreading information in the market process, apart from price signals. Communication about products and their particular advantages is responsible for the broad range of choices consumers enjoy today. It is necessary to make consumers aware of the diverse possibilities to relieve perceived problems; sometimes advertising has to awaken feelings of uneasiness which encourage the consumer to search for a solution towards his problem.

Austrian marketing-managers can make use of the communication- and distribution-strategy to convince customers of the advantages of their particular offers besides offering a product that fulfils a customer need at a competitive price. Human actors’ property of subjectivism implies that advertising can influence the subjective perception of value. Marketing can alter human actors’ tastes and preferences in a desired direction. Thus it is not absolutely necessary to offer the objectively best opportunity in a market. It is enough to have the subjectively best one. Modern marketing can and often does transcend the objective value of a product by emphasising subjective qualities like ‘image’ or ‘spirit’. Some consumers endorse the image a brand or good represents through buying the good in question. Their willingness to pay for such a good is often much higher than for a good that does not contain value that was added by communicative means. Some designer-labels for clothes e.g. add that much extra-value through information to their products that they are able to exploit consumers’ subjectivism. These companies can charge the multiple amount of money for the same basic good such as a jeans or T-shirt in comparison to another competitor who is not that much involved in heavy advertising or who is not as successful with his communicative strategy.

The chances of engaging in an exchange are subject to the amount of information both parties possess. If someone objectively has the best offer available but is unknown to potential partners, he will not succeed in the market process. The potential market for a certain offer is enlarged through the information of customers. In a world

³¹⁵ Kirzner (1972).

of overstimulation only the loud voices will be heard. Put differently, the more people know about an offer, the bigger will the potential market for this offer be. A change of price is c.p. not the only possibility to reach more customers. A market is independently enlarged in Austrian economics by reaching new customers via information. Recent developments in information technology like the World Wide Web have opened many new opportunities to reach customers in almost all parts of the world. Auction platforms in the internet, like eBay, make use of these enhanced informational capabilities to bring together buyers and sellers from all continents. The importance of problems referring to the quality of the product, the buyer, and the seller may rise in the virtual marketplace compared to a face-to-face exchange but the transparency of the pricing mechanism and the size of the market, which is potentially only limited to the number of the human population are important advantages that enhance market processes. Even though exchanges are dyadic, both buyers and sellers need to pay attention to competitive offers and bidders. It is advantageous for both sides of the exchange to know of a relevant market that is as large as possible, because then it is possible to compare and evaluate different offers. Competitive bidders are, like the buyer and seller, in a constant process of learning to offer and accept better opportunities than before.

A seller who at least once engaged in an exchange with a buyer has a certain informational advantage. The buyer is not radically ignorant about the categories or types of product- and service-offers of the seller anymore. It is easier to inform a person who is already aware of the company about related and follow-up offers. An initial exchange can thus become the starting-point for a number of exchanges. Yet, the occurrence of experience and learning can take a turn for the worse for the position of the exchange partner in a subsequent period, if the initial exchange was unsatisfactory for one or both sides.

5.3.4 The Distribution Strategy in the Market Process

Finally, the fourth instrument – the distribution strategy – has only a small place in Austrian economics. The marketing-manager needs to care for a good distributional strategy, because a need-satisfying product must not only be known to the addressee, but it must also be readily available. A consumer who is alert to an offer but does not know where to satisfy his demand may be reluctant to invest too many resources in the reduction of his ignorance about this product feature. The market process forces

the seller to secure a distribution strategy that makes his offers available at all places where it is worthwhile. Some products may be valuable only in particular places; e.g. the market chances for air conditioning will be larger in Florida than in Norway, but things like clothes and food are valuable almost anywhere where human population is found.

6 Conclusions and Summary

Even though Austrian economics is a theory with a high potential as a general marketing theory, it is probably not the one theory that will unite all marketing researchers and help to overcome all problems of marketing theory, because unfortunately some important impediments limit its possibilities. The good news is that Austrian economics and marketing are both interested in the explanation of market phenomena and their origin in human action.³¹⁶ The reproach of mainstream economists that marketing is a waste of economic resources³¹⁷ becomes obsolete in Austrian economics. The whole market process would, quite to the contrary, come to a halt in a state of disequilibrium without the information that is spread by marketing measures. The information about opportunities allows buyers to reduce ignorance and to express their will through channelling resources to efficient purposes. Information is furthermore responsible for enlarging markets. Economies of scale can only be realised in a large market. It follows that marketing is responsible for lower production costs, fiercer competition between different sellers and, finally, prices that are closer to equilibrium than they would be without the possibility of spreading information through advertising. An empirical look at real markets supports this idea: Buyers and sellers gather experience; they learn if they paid too much or asked too little. Profitable opportunities erode in competition, but as the process takes time, opportunities temporarily exist – sometimes vanishing fast, sometimes fading away slowly.³¹⁸ The other instruments of the marketing-mix are part of Austrian economics, too. Pricing policy, product policy, and distribution policy based on Austrianism offer valuable implications to be successful in the marketplace. Focusing on the customer and being always alert to his obvious and hidden desires is the main idea for marketing in order

³¹⁶ Cf. Mises (1949), p. 233.

³¹⁷ Cf. Doyle (1968), p. 570.

³¹⁸ Cf. Plinke (2000b), pp. 61f.; Kirzner (1997), p. 70. Most studies find a convergence of abnormal profit rates to average levels, cf. Jacobson (1988), p. 415.

to engage in exchanges. Austrian economics is best applied to commercial exchanges that are driven by the profit motive. It is conceivable to apply it to marketing in internal markets, but some difficulties arise if Austrian economics is applied to non-profit marketing.

The strength of Austrian economics as a marketing theory is in its descriptive and explicative powers. It has become apparent that Austrian economics is very well suited to describe and explain the two basic phenomena of marketing, i.e. why people and organizations engage in exchange relations and how these exchanges are created, resolved, or avoided. Buyers strive to subjectively maximize their independently chosen goals in the market. They engage in exchanges which help them reaching their individual goals. These exchanges create a positive net value. Sellers as the opposing party of the exchange are trying to maximize their own ends. They are first and foremost driven by the profit-motive, but Austrian economics is accepting other motives as well, as long as market prices are an unambiguous signal of supply and demand for a good or service. Mutual alertness in regard to opportunities improves the situation of all parties in the marketplace. Information is thus a valuable good in Austrian economics. Austrian economics describes the qualities of the entrepreneur as being bundled in alertness. These qualities are aggressiveness, boldness, creativeness, and leadership qualities (see section 4.2.2, p. 27). It would be an interesting task to find out if people who are successful marketing-managers are characterised by the same qualities.

Austrian economics describes and explains institutions that are relevant for exchanges and it can account for consequences on the society of the behaviour of the buyer, seller, and the institutional framework. It is a valuable theory for criticism of societal circumstances and other theories which claim importance for marketing. It e.g. allows criticizing Communist central planning and government interventions. Competing theories like neoclassic microeconomics are criticized with the claim of the superiority of Austrianism. Furthermore, it was shown that both the neoclassic and behaviouristic, as well as the Resource-advantage theory and genuine marketing theories like the Bass-Model can be related to or integrated into Austrian economics. Due to these innate qualities, Austrian economics can claim credibility as a general marketing theory.

The limitations of Austrian economics are intrinsic in its assumptions. While they are a good reflection of real deciders and decision-making in the marketplace, they are causal of the immunization tendencies of Austrianism. The assumption of radical ignorance, subjectivism and the free will of the individual to choose, change and create are an obstacle to empirical testing of the hypotheses of Austrian economics. They open the possibility of ad-hoc explanations of empirical findings that are contradictory to theoretical implications. Thus, the falsifiability of Austrian economics in a Popperian sense is excluded. It becomes possible to derive regularities or statements of invariance only, if certain traits are assumed to be stable over a certain period. Then it is possible to derive rather general rules from Austrian economics in its present form for marketers to influence transaction processes. Austrian economics has a strong point in regard to the novelty of its implications in comparison to other theories in marketing. Its weaker points, which are its limited truth and especially its limited empirical content, determine the predictive power of Austrian economics and its potential of technological usage. It is impossible to derive flawless prognoses from Austrian economics since the secondary conditions human behaviour cannot be actively controlled. 'Austrian' techniques or policies must be taken with a grain of salt as decision rules for marketing decision makers. There are some empirical studies on basis of 'Austrian hypotheses', but further research that could help to heal the weaknesses of Austrianism is desirable. A first step could be to compare 'Austrian predictions' with historical data. Then, research on limited problems within the limits of Austrian economics could serve to derive specific implications to influence transaction processes, until the causes of the occurrence of surprises and the dissolution of radical ignorance are perhaps found at some point in the future.

The work at hand has analysed the potentials and limitations of Austrian economics in regard to marketing theory. In order to do that, the realm of marketing has been shown at first. Next, epistemological principles were described and explained. The following section depicted Austrian economics. The analysis in the main part referred to a qualitative assessment of Austrian economics in regard to criteria from the philosophy of science, potential applications of Austrian economics and its powers to derive implications to influence transaction processes.

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Appendix

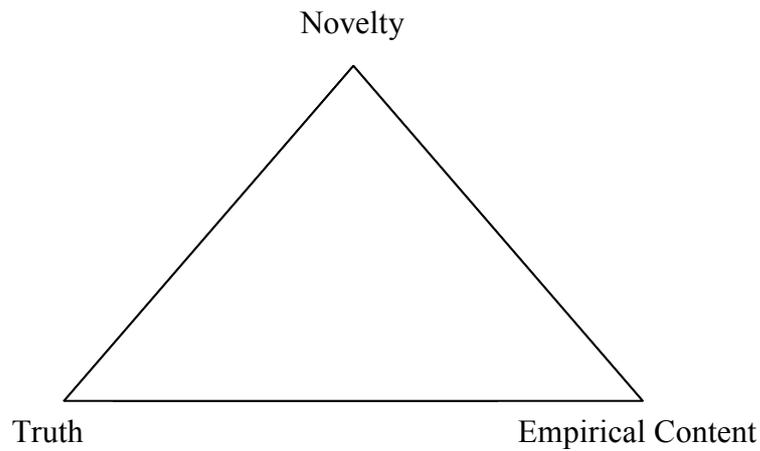


Figure 1: The 'Triangular problem' of novelty, truth, and empirical content.
Source: According to Chmielewicz, K. (1994), p. 131.

Explanation		Prognosis
Searched	Law (If the sun shines, then we go out for a walk).	Given
Searched	Secondary conditions (The sun shines).	Given
Given	Explanandum (We are going out for a walk).	Searched

Figure 2: Differences between explanation and prognosis (Example in brackets).
Source: According to Schanz, G. (1988), p. 66.

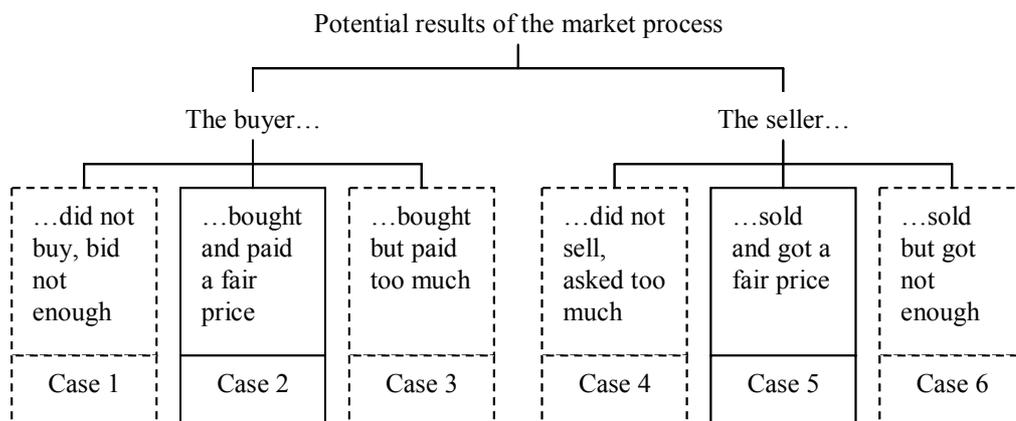


Figure 3: Six potential outcomes of the market process.
Source: According to Plinke, W. (2000), p. 60.