

First Conference on Albert Hirschman's Legacy: theory and practice  
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# “The power of failure and the courage of creativity”

The principle of the Hiding Hand  
and its evolution in the new entrepreneurial behavior

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## Abstract

*All humans are entrepreneurs not because they should start companies but because the will to create is encoded in human DNA (Reid Hoffman, LinkedIn cofounder)*

For New Entrepreneurs, starting a business is no longer just a form of making a living. It is who they are. Although they do need to make money and support their families, just making a living is the old-school approach. Nor do they look at a business as another type of job. Instead, business is a blank canvas waiting to be colored with their passions, values, and mission<sup>1</sup> - with creativity.

The link between creativity and entrepreneurship was brightly expressed by Albert O. Hirschman in his essay *The Principle of the Hiding Hand*. He postulates that creative solutions most frequently come from adapting to tasks that turn out to be more challenging than we expect.

The evolution of the entrepreneurship has demonstrated that creativity plays a critical and important role in the entrepreneurial process, which could be for profit or not. Uncreative entrepreneurship doesn't exist.

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### 1. The evolution of entrepreneurship and the role of creativity and innovation

*You never change things by fighting the existing reality. To change something, build a new model that makes the existing model obsolete. (Buckminster Bucky Fuller, architect, inventor)*

The role of entrepreneur was recognized by the research in the eighteen-century in France, at first from the economist Richard Cantillon who linked the “risk-bearing” activity in the economy with the entrepreneur. During the same historical time the Industrial Revolution was progressing in UK, having the entrepreneur playing an important role in risk taking. The connection of entrepreneurship and economics has been widely recognized as a rule, in fact all the definitions of this specific category of innovators and profit producers, who have an impact on the economic development, came from economists: the before mentioned Cantillon (1725), Jean Baptiste Say (1803), and the twentieth-century economist J. Schumpeter (1934).

The word entrepreneur is rooted in the French *entreprendre*, meaning “to undertake”, one who undertakes to plan, manage, and takes the risk of a business.

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<sup>1</sup>The New Entrepreneurz: Changing the Way You Play Life, Ronen Gafni, Simcha Gluck

The recognition of entrepreneurship proposed by the economists of the eighteenth century, continued to be discussed by the economists in the nineteenth century. In the twentieth century the word entrepreneurship became synonymous with free enterprise and capitalism. The entrepreneur was recognized as the agent of change; the one who brings creative, innovative ideas to the market; and help businesses grow and become profitable. In the twenty-first century many of the entrepreneurs have used CREATIVITY and INNOVATION to start multimillion-dollar enterprises from emerging businesses. These people have created new products and services, and have assumed the risks related to these ventures.

Entrepreneurship is a dynamic process of vision, change, and creation. It requires an application of energy and passion toward the creation and implementation of innovative ideas and creative solutions. Essential ingredients include the willingness to take calculated risks - in terms of time, equity, or career; the ability to formulate an effective venture team; the creative skill to marshal needed resources; the fundamental skill of building a solid business plan; and finally, the vision to recognize opportunity where other see chaos, contradiction, and confusion.

An entrepreneur is an INNOVATOR who identifies and seizes opportunities; transforms those opportunities into marketable ideas, assumes the risk of the competitive world to implement these ideas, and realizes the profit from these efforts. The entrepreneur is the aggressive catalyst for change in the world of business. The literature of entrepreneurial research reveals some similarities, as well as a great many differences, in the characteristics of entrepreneurs. Although no single definition of entrepreneur exists and no one profile can represent today's entrepreneur, the world currently is in the midst of a new wave of business and economic development, and entrepreneurship is its catalyst.<sup>2</sup>

Innovation is commonly regarded as the *successful implementation* of creative ideas and its acceptance by various stakeholders in organizations<sup>3</sup>. CREATIVITY is considered a necessary, but not sufficient pre-condition for innovation<sup>4</sup>.

Creativity is distinguished in the literature from *innovation*, considered the crafting of creative solutions into new products, processes, or services<sup>5</sup>, as the outcome of ideas that are novel, useful and appropriate. Creativity is important to entrepreneurs because it is the first stage in the process of innovation, providing the stimulus for opportunity discovery and new venture creation. One of the first tasks requested to an entrepreneur is to show creative ability through the invention of new product-market opportunities and unique value propositions. Creativity, in the form of the ability to effectively

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<sup>2</sup> Entrepreneurship: Theory, Process, and Practice By Donald F. Kuratko

<sup>3</sup> Oldham and Cummings, 1996

<sup>4</sup> Mum- ford et al., 2012

<sup>5</sup> Woodman et al., 1993

generate novel solutions to relevant problems, can be a source of significant competitive advantage, especially in rapidly changing environments.<sup>6</sup>

The new environment demands renewed dynamism of approach. Creativity and innovation are the new name of the game. Only the discerning organizations can manage the changes inherent in the new environment. It is the duty of the entrepreneur to keep his/her organization lean, young, flexible, and eager for new things to continuously delight the customers, which is the purpose of every business.<sup>7</sup>

The twenty-first century has also witnessed a new category of entrepreneurs in the field of Information and Communication Technology (ICT). As Amit and Zott (2001) note, “business conducted over the internet (e-business), with its dynamic, rapidly growing, and highly competitive characteristics, promises new avenues for the creation of wealth”<sup>8</sup>. This motivates the creation of a new breed of business people defined as e-entrepreneurs. Creativity plays a crucial role in the success of an innovation particularly because it enables individuals to overcome obstacles<sup>9</sup> that might have prevented the success. Creativity is a characteristic of particular relevance to e-entrepreneurs as they will need to be able to respond rapidly and in novel ways to an environment in which the only constant is change<sup>10</sup>. These changes are “largely driven by new technology and globalization” [resulting in] a competitive landscape with substantial uncertainty<sup>11</sup>.

The success of an ICT venture by an e-Entrepreneur in a very competitive and unpredictable environments will mostly depend on the innovation combined with the ability of the entrepreneur to creatively respond to opportunities and threats.

Following the wind of creativity and innovation for the new generation of entrepreneurs, it is mandatory to identify a special category of business where this creative and innovative entrepreneur can express his/hers ideas, accordingly with the high speed of the market: the startup’s world.

“A startup is a company working to solve a problem where the solutions is not obvious and success is not guaranteed” says Neil Blumenthal, cofounder and co-CEO of Warby Parker; accordingly to the American Heritage Dictionary it is “a business or undertaking that has recently begun operation.” One thing that all can agree on is that the key attribute of a startup is its ability to grow fast, unconstrained by geography.

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<sup>6</sup> Creativity: Linking Theory and Practice for Entrepreneurs, Tom Duxbury, 2012

<sup>7</sup> The value of creativity and innovation in entrepreneurship, Dr. Friday O. Okpara, Un. of Gondar, Ethiopia

<sup>8</sup> Amit and Zott, 2001, p 493

<sup>9</sup> Amabile, 1996;1993

<sup>10</sup> Brown, & Eisenhardt, 1998

<sup>11</sup> Hitt et al., 2001 pp. 479-480

The quick growth of startups is also facilitated by incubators and accelerators. According to the National Business Incubator Association (NBIA), an incubator is "a business support process that accelerates the successful development of startup and fledgling companies by providing entrepreneurs with an array of targeted resources and services. These services are usually developed or orchestrated by incubator management and offered both in the business incubator and through its network of contacts." "One of the ways to think about incubation and entrepreneurship is that they help increase entrepreneurial success, opportunity and are able to strengthen communities," said Micah Kotch, director of innovation and entrepreneurship at Polytechnic Institute of New York University, which runs the Varick St., NYC ACRE and DUMBO incubators.

Those programs increase the chances of success by offering things like office space, professional services and business advice, for small monthly fee to participate in the program. Those fees can range from a few hundred to a few thousand dollars.

Incubators do not generally have a strict focus on the amount of time a business will spend in the program. For example, companies at the NYU Poly incubators generally spend 18 months in the program, but other incubators may have a longer time frame.

Thanks to the recent interest in incubators, programs are now offered for companies from all different industries, ranging from tech and retail to restaurants and media, among many others. Accelerators are interested in achieving the same overall goal of helping to improve the odds of success for startups, but these programs go about achieving that goal in a very different way. First and foremost, accelerators generally make an investment in the companies enrolled in their programs. In addition to making an investment in the company, accelerators also differ from incubators in the time companies spend in the program. Accelerator programs are designed to be concise and generally take three to four months to complete.<sup>12</sup>

This new breed of entrepreneurs, facilitated to grow fast in this global business environment, has two words mostly used to describe it, and its world: INNOVATION and CREATIVITY.

## 2. Failure and Creativity in The principle of the Hiding Hand

*"I have not failed. I've just found 10,000 ways that won't work." - Thomas A. Edison*

Fifty years ago, in 1967, Albert O. Hirschman published the book "Development Projects Observed", in which he applied and explained the Principle of the Hiding Hand: "Social planners in underdeveloped countries have to be unrealistically optimistic; if they're realistic, then no projects would be undertaken. They underestimate threats and their own responses to failure. They also overestimate the

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<sup>12</sup> By David Mielach, BusinessNewsDaily

likelihood of success. They neglect a set of possible and unsuspected threats to profitability and even to project's existence. Link to planning fallacy starts here. But through human creativity, they figure out unexpected solutions. Hiding Hand beneficially hides difficulties and the result is just like expected or even better than they thought. This is secured by providential ignorance.

Hirschman had studied one of the earliest large-scale Paper Mill set up in Pakistan after partition and independence. The mill was built to exploit the vast bamboo forests of the Chittagong Hill Tracts. No longer the mill started the operations in 1953, the bamboo unexpectedly flowered and then died, a phenomenon that happens every seventy years or so. Dead bamboo was useless for pulping. Because of ignorance and bad planning the industrial plant was without the raw material to function. What impressed Hirschman was the reaction to the crisis. "In a temporary and costly way, the problem was solved by importing pulp, but other, more creative responses were not long in coming: an organization to collect bamboo in villages throughout East Pakistan was set up (the waterways crisscrossing the country make for cheap transportation of bulky cargo), sundry lumber was cut in the Tracts, and, most important, a research program got underway to identify other fast growing species which might to some extent replace the unreliable bamboo as the principal raw material base for the mill."<sup>13</sup>

From this first point Hirschman's analysis took flight.

Two techniques play a role in this principle: 1. the pseudo-imitation is when planners-entrepreneurs think their project is a direct application of an extensively successful and well-known technique, making the tasks seem less arduous; 2. pseudo-comprehensive program technique when planners-entrepreneurs give the illusion that all answers have been found, by other trustable researchers or institutions, and for this reason they proceed to a faithful application. No need for imagination or creative energies. In this case it seems that the task is known in its whole.

Both techniques imply a lack of knowledge of all the elements needed to deepen the analysis.

The *pseudo-imitation technique* was recognizable in any river valley development scheme for a number of years in the post-World War II period. Whether it concerned the Sao Francisco River in Brazil, the Papaloapan River in Mexico, the Cauca River in Colombia, the Dez in Iran, or the Damodar River in Eastern India, was presented to a reassured public as a true copy, if possible certified expressly by David Lilienthal, of the TVA. Although obviously two river valley development schemes will differ vastly more from one another than two Coca Cola bottling plants, the impression was created, by the appeal to the "TVA model," that clear sailing lay ahead for the proposed schemes. To be acceptable, it seems, a project must often be billed as a pure

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<sup>13</sup> The Principle of the Hiding Hand, Albert. O. Hirschman

replica of something that already exists as a successful venture in an advanced country. An excellent example of the *pseudo-comprehensive program technique* is supplied by the Uruguayan livestock and pasture improvement project. It started with the avowed aim to "implement" a joint World Bank-United Nations report issued in 1951 whose recommendations covered an extremely wide spectrum as will appear from the following incomplete list of topics: subdivision of pastures by fences, grazing trials, tree plantings on permanent grasslands, introduction of legumes, increased use of lime and phosphate, shrub eradication, works to control runoff water, establishment of fodder reserves through silage and hay [...]Such a report tends to give the policy makers and project planners the illusion that the "experts" have already found all the answers to the problems, and that all that is needed is faithful "implementation" of these multifarious recommendations. The comprehensive program, whose many components all are given the same emphasis and are pronounced to be interrelated, in effect covers up the ignorance of the experts about the real cure of the malady they have been summoned to examine; if they knew, they would be proposing a far more narrowly focused program!<sup>14</sup>

The article had an immediate impact, this has to be remarked. Hirschman's ideas were picked up by policy makers and practitioners—from Washington's policy establishment to the United Nations, to the World Bank and development agencies around the world. Andy Kamarck, head of the World Bank's Economics Department, told Hirschman: "You've helped in part to remove the unease that I have had in reflecting on the fact that if our modern project techniques had been used, much of the existing development in the world would never have been undertaken. It may be that with a further working out of the ideas that you explore in this chapter [Chapter One, "The Principle of the Hiding Hand"], we can avoid this future inhibitory role of economists".<sup>15</sup>

Hirschman's "Development Projects Observed" was recently republished as a Brookings Classic in 2015, with a preface by the author dated 1994, admitting the limits of his principle.

In fact, Hirschman gives an explanatory interpretation of the stories told to apply the principle of the Hiding Hand, which weren't "*meant to hold any immediately applicable practical lesson. Yet did have a purpose closely connected with [his] hidden agenda: to endow and surround the development story with a sense of wonder and mystery that would reveal it to have much in common with the highest quests undertaken by humankind. Moreover, when [he] wrote the book in the middle 1960s the scientific determination of correct investment choices seemed to be within reach. In the U.S. Department of Defense, under the leadership of Robert McNamara much was made of new methods: PPBS - planning, programming, and budgeting system-*

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<sup>14</sup> The Principle of the Hiding Hand, Albert. O. Hirschman

<sup>15</sup> Adelman, 2013, p. 405

*that acquired a considerable prestige. In the World Bank, investment choices and decisions were similarly expected to be made more rational through various devices known as “shadow prices”, “social benefit cost analysis”, and other sophisticated new techniques. In this intellectual atmosphere the chapter one dedicated to “The Principle of the Hiding Hand” was close to a **provocation**. Nothing could be less operationally useful than to be told that underestimating the costs or difficulties of a project has on occasion been helpful in exciting creative energies that otherwise might never have been forthcoming.”*

Hirschman concluded his preface saying that he passed through several experiences of arguing against his own earlier propositions, because he noted that they were less general than he originally thought. With his words: “I have talked about these experiences as *self-subversive* acts and eventually discussed them-and their uses- in a chapter under the heading “A Propensity to Self-subversion”. This is also the title for my next book of essays.”<sup>16</sup>

This self-criticism of the author of the principle of the Hiding Hand was not taken in consideration from all his detractors, in fact the Hiding Hand received several critics. Scholars and practitioners looking for clear, replicable appraisal standards were disappointed, including promoters of ex ante cost/benefit analysis<sup>17</sup>. As observed by Lepenies (2008) and Bianchi (2011), with the Hiding Hand Hirschman pointed a finger at cost/benefit analysis, which enjoyed high prestige among World Bank experts, and his targets responded in kind. Others found Hirschman’s arguments “unconvincing” based on the insufficient number of projects he observed (only 11)<sup>18</sup>.

Despite the critique, nearly 50 years after its initial publication, Development Projects Observed is still going strong, with a celebration of its ideas, including the Hiding Hand, by Malcolm Gladwell in The New Yorker<sup>19</sup>, a dedicated study by a professional historian of the genesis of the book calling it “groundbreaking”<sup>20</sup>.

Today, in spite of favorable and opposing theories, the major value of The Principle of the Hiding Hand must be acknowledged to have brought to light a concept that today has gained enormous importance among the fast growing world of entrepreneurs: **THE POWER OF FAILURE**, which triggers the first and foremost quality of every entrepreneur, the **CREATIVITY**. Hirschman was delighted by human foibles and even more, he celebrated human creativity.

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<sup>16</sup> A.O. Hirschman, Development Projects Observed, 2015, p. 12-13

<sup>17</sup> Alacevich, 2014, p. 153, 156, 161–64; Little & Mirrlees, 1968; Reutlinger, 1970; Squire & Van der Tak, 1975

<sup>18</sup> Cracknell, 1984, p. 17; Lal, 1983, p. 176

<sup>19</sup> Gladwell, 2013

<sup>20</sup> Alacevich, 2014, p. 139

In Hirschman's words, "Creativity always comes as a surprise to us; therefore we can never count on it and we dare not believe in it until it has happened. In other words, we would not consciously engage upon tasks whose success clearly requires that creativity be forthcoming. Hence, the only way in which we can bring our creative resources fully into play is by misjudging the nature of the task, by presenting it to ourselves as more routine, simple, undemanding of genuine creativity than it will turn out to be". Ignorance as a precondition of progress.

The positive approach of Hirschman on the entrepreneurs' decision process makes easy to think that they will implement solutions that look attractive but are hard to achieve, and will overestimate the predictable results.

The key mechanism driving the Hiding Hand is optimism caused by an ignorance of difficulties, including costs, which leads people to take on tasks they would not have taken up had they known the real challenges involved. In sum, the Hiding Hand does its work through beneficial ignorance—or "ignorance of ignorance" as Hirschman (1967a, p. 35) put it. Beneficial ignorance hides two things from decision makers. First, the true costs and difficulties of projects remain obscure, which makes planners take up projects they would not have considered, had they known their true complications. Second, the Hiding Hand also conceals planners' problem-solving ability in dealing with costly and difficult projects, which makes planners able to successfully deal with such projects when the difficulties manifest themselves, at which time the planners' concealed abilities become overt and save the day. Overall, the Hiding Hand is therefore a good thing, according to Hirschman and his followers, because it makes projects go ahead and succeed—based on beneficial ignorance—that would not have done so had planners known at the outset the real costs and difficulties.<sup>21</sup>

The entrepreneur takes risks but does not see himself as a risk-taker, because he operates under the useful delusion that what he's attempting is not risky. Then, trapped in mid-mountain, people discover the truth—and, because it is too late to turn back, they're forced to finish the job.

Success grew from failure:

And essentially the same idea, even though formulated, as one might expect, in a vastly different spirit, is found in Nietzsche's famous maxim, "That which does not destroy me, makes me stronger." This sentence admirably epitomizes several of the histories of economic development projects in recent decades. As was nearly always the case with Hirschman's writing, he made his argument without mathematical formulas or complex models. His subject was economics, but his spirit was literary. He drew on Brecht, Kafka, Freud, Flaubert, La Rochefoucauld, Montesquieu,

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<sup>21</sup> Flyvbjerg, B. The Fallacy of Beneficial Ignorance: A Test of Hirschman's Hiding Hand, *World Development* (2016), <http://dx.doi.org/10.1016/j.worlddev.2016.03.012>

Montaigne, and Machiavelli, not to mention Homer—he had committed huge sections of the *Odyssey* to memory. The pleasure of reading Hirschman comes not only from the originality of his conclusions but also from the delightfully idiosyncratic path he took to them.<sup>22</sup>

Hirschman was an optimist looking for solutions, analyzing the human behavior in an entrepreneurial settlement, enhancing the problem solving skills of those humans in situation of crisis.

Hirschman was looking for positive answers to move forward, instead of finding reasons to step back. He recognized the power of the human creativity to overcome failures. It is laudable that he admitted the limits of his research, but it is undeniable the great contribution he gave to the future vision of entrepreneurship and to the new generation of entrepreneurs. SUCCESS GROWS FROM FAILURES.

#### 4. Examples of overcoming failures: FailFaire

The power of failure is one of the major aspect of success, fostered by innovation, creativity, strategy and execution in the world of the entrepreneur of the 21st century, who lives in the new fast business environment, populated by startups, e-economy, incubators, and accelerators. Vijay Govindarajan, Coxe Distinguished Professor at Dartmouth's Tuck School of Business and a Marvin Bower Fellow at Harvard Business School, author of "The Three Box Solution: A Strategy for Leading Innovation", synthesizes the innovation equation with the combination of three variables: strategy+creativity+execution.

The need to experiment and fail inexpensively in Execution is where most of the focus is these days. Ironically, the relatively low risk and low cost of experimenting with seemingly dead ideas during Creativity is still one of the keys to lowering the high risk, high cost and high rate of failure in Execution. Companies like Facebook -- which encourages employees to "move fast and break things" -- and Pixar -- which tells workers to "fail early and often" -- are examples of successful American companies finding that the best way to succeed is to fail, and fail repeatedly. According to John Maxwell's *Failing Forward*, the average entrepreneur fails 3.8 times before he or she finally makes it in business.

There is a new place where every failure is celebrated as a lesson for success: the FAILFaire conference, a place to de-stigmatize failure, and talk about progress, innovation and success. The FailFaire itself is an expression of creativity, a reaction to the unknown world of possible mistakes. The entrepreneur, in this case, has created

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<sup>22</sup> The Gift of doubt, Malcolm Gladwell, The New Yorker, 2013

his/her own trustable source of knowledge, almost like a pseudo comprehensive program technique. The ability to take risks, learning from others' mistakes.

“Not talking about [failure] is the worst thing you can do, as it means you're not helping the rest of the organization learn from it,” said Jill Vialet, who runs the nonprofit Playworks. “It gives [the failure] a power and a weight that's not only unnecessary, but damaging.” Vialet instead supports failing “out loud” and “forward,” meaning that the people involved in the failure should speak about it openly and work to prevent history from repeating itself.

This next level of an improved Hiding Hand started in 2010, among members of the non profit community, from an idea of Katrin Verclas, who is with a nonprofit group in New York called MobileActive. She wanted to provide an opportunity for people to learn from the mistakes of others: “Development is a field with finite resources, and so the less money we waste, the better. And part of that is learning from the things that didn't work, so that we don't endlessly repeat them”.

Together with this periodic event to discuss failures and learn how to avoid similar mistakes, there are other promoters of the same idea: DoSomething.org, a nonprofit that supports social change among teenagers, by holding a bi-annual Fail Fest conceived and hosted by its chief executive, Nancy Lublin; others publish their failures for the world to see; Engineers Without Borders Canada, which creates engineering solutions to international development problems, publishes a “failure report” every year alongside its annual report. “I only let the best failures into the report,” said Ashley Good, its editor. The examples that are published, she said, show people who are “taking risks to be innovative.”

Building a culture of openness to failure takes time and consistent effort. Continuing on this path it would have been interesting to see Albert Hirschman's reaction.

The Principle of the Hiding Hand had the limit of having analyzed a circumscribed number of projects, and elaborated less data due to the restrictions of the time when the author elaborated it. That said, it gave the positive vision of a different perspective, which today would have led to every FAILFaire with the awareness of not only learning from others' mistakes, but to find an answer to those mistakes with the courage of CREATIVITY.

Albert O. Hirschman would probably have introduced a second phase to the FAILFaire as an applied research for creative solutions, trying to give answers to failures.