



Entrepreneurship and employment stability – Job matching, labour market value, and personal commitment[☆]



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ABSTRACT

This paper challenges the conventional belief that entrepreneurship is an unstable career path. Using longitudinal matched employer–employee data from Denmark, the analysis reveals that a transition to entrepreneurship decreases individual's employment turnover tendency. Three explanations are identified and empirically explored: (i) job matching, (ii) labour market value, and (iii) personal commitment. Entrepreneurs appear to be more productive and thus better matched compared to wageworkers. However, they also appear to be locked in entrepreneurship because of their anticipated lower value in the labour market and because of their personal attachment to the venture. The counter-intuitive finding – entrepreneurship yields greater employment stability – only holds with respect to subsequent transitions to wagework and not for new venture founding. The results have implications for our understanding of entrepreneurial entry and labour market dynamics.

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Executive summary

Although there is an active and growing literature on the returns to entrepreneurship (Hamilton, 2000; Hyytinen et al., 2013), little is known about the effect of entrepreneurship on individual's job stability. This is surprising given that job stability may be the result of workers being better matched to a specific firm, and in turn being more productive in that organizational setting (Jackson, 2013; Jovanovic, 1982). Moreover, entrepreneurs tend to have a history as job hoppers (e.g. Astebro and Thompson, 2011). Hence, it becomes interesting to understand the sources of this job hopping tendency and whether becoming an entrepreneur induces a change in this behaviour.

Accordingly, this paper addresses the question of whether entrepreneurship is associated with a downward shift in the individual's turnover rate. Longitudinal data covering the population of individuals active in the Danish labour market are used to estimate differences in turnover rates between entrepreneurs and comparable wageworkers identified by means of a propensity score matching technique. While entrepreneurship is often portrayed as an unstable career associated with high failure rates, we find that, conditional on moving, entrepreneurship yields greater job stability. The paper offers empirical evidence around three mechanisms potentially contributing to this downward shift of individual's employment turnover rate: (i) job matching;

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(ii) labour market value; and (iii) personal commitment. Entrepreneurs appear to be better matched in their employment status where job matching is modelled as average residuals in an income regression with firm and individual fixed effects. Yet, we also find evidence of lock-in effects. Lower turnover among entrepreneurs is partly attributed to an expected pay cut upon returning to the wage sector which discourages exit and to a personal commitment effect ascribed to psychological attachment and escalation of commitment.

These findings are central for our understanding of the rewards available to potential entrepreneurs and thus for better modelling the decision to become entrepreneur. In addition, there are implications for both policy makers and researchers, which we discuss below.

Implications for policy makers

We believe our results contribute to an understanding of the net effects of policies aiming at channelling workers into entrepreneurship. First, the costs associated with subsidising entrepreneurship should be evaluated in light of the expected time in entrepreneurship relative to the expected tenure in an established firm. Our results suggest that these policies should target individuals with above average turnover tendencies to reap the benefit of employment stability and, in turn, alleviate the frictional costs associated with high employment turnover. Second, our evidence of higher residual earnings for entrepreneurs compared to movers in the wage sector suggests that policies attracting movers to entrepreneurship may also increase their productivity by securing them a high quality match. However, our results also point out that entrepreneurship lowers individuals' labour market value, which in turn hinders exit from entrepreneurship and introduces frictions at the point of re-entry in the wage sector. This corroborates the need to adopt a selective approach rather than a one-size-fits-all approach. Policies should target individuals whose benefits associated with stability and job matching are the highest. This will minimize the risk of failure or offset the cost of the entrepreneurial discount in case of exit and return to the wage sector.

Implications for researchers

This research improves our understanding of the entrepreneurial entry decision. First, finding greater employment stability among entrepreneurs contributes to a more comprehensive understanding of the rewards available in entrepreneurship. This has fundamental implications for whether we interpret the monetary returns as justified, especially in light of the fact that leaving an entrepreneurial venture is costly (Gimeno et al., 1997).

Second, the finding that movers are more productive in entrepreneurship, exhibiting higher earning residuals, extends the debate on whether entrepreneurship does pay. While it is well documented that entrepreneurs on average earn less, emerging research has started questioning it (see e.g. Astebro and Chen, 2014; Manso, 2016). Drawing on recent advances in labour economics to estimate match effects (Jackson, 2013), we suggest that looking at the residual earnings rather than at the observed earnings differentials may prove promising to re-estimate the monetary returns. This method may be better at capturing the unobservable component of entrepreneurial ability. An interesting research route could be to compare the two approaches to identify sources of discrepancies and ultimately shed more light on the entrepreneurial earnings puzzle.

Finally, our analysis suggests that the documented high employment turnover rates among waged workers before moving to entrepreneurship (Astebro and Thompson, 2011) can be ascribed to an interaction between employment contexts and individual preferences (job mismatch), and less to innate attributes of this selected group, i.e. a taste for variety. Sorting out the mechanisms of job mismatch and taste for variety would be another interesting topic for future research.

1. Introduction

Although scholars of entrepreneurship have extensively focused on whether entrepreneurship pays (see e.g. Georgellis et al., 2007; Hamilton, 2000), little is known about the effect of entrepreneurship on job stability. This gap is surprising because job stability plays a central role in determining individual's choices about where to work, firms' hiring and retention policies, and in public policy concerned with the welfare effects of turnover (see e.g. Jackson, 2013). Job stability is of particular interest in the entrepreneurial setting because an increasing number of policies are aimed at subsidising entrepreneurship. It has thus become important to understand whether these policies have a long-lasting effect and whether potential stability among entrepreneurs is a desirable outcome in the labour market. Accordingly, this paper examines whether and why the transition to entrepreneurship affects job stability.

Entrepreneurship is often portrayed as a risky, unstable career choice. Most periods of entrepreneurship are relatively short lived (see e.g. Kaiser and Malchow-Moller, 2011; Taylor, 1999). Start-ups fail relatively quickly (Evans and Leighton, 1989), and entrepreneurs have skewed and volatile earnings (Parker, 1997). For example, a recent study by Kaiser and Malchow-Moller (2011) using Danish data found that among new entrepreneurs, only 35.6% had persisted in entrepreneurship after five years. Hence, entrepreneurship may be viewed as a transitory occupation that entrepreneurs leave relatively quickly.

We challenge this view and suggest that entrepreneurship is in fact associated with greater employment stability. We propose and test three theoretical mechanisms. The first is a positive matching process between individuals that select into entrepreneurship and the inherent features of being an entrepreneur. The second is a lock-in effect attributable to relatively poorer outside options in the labour market. Finally, the third mechanism is another form of lock-in, wherefore personal commitment to the business causes behavioural delays.

This study has important implications for ongoing conversations in entrepreneurship. First, research on the returns to entrepreneurship typically documents that entrepreneurship does not pay (see e.g. Hamilton, 2000). Yet, a growing number of studies appears to question this view by accounting for alternative explanations such as income underreporting

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