



The imprint of labor markets on entrepreneurial performance



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ABSTRACT

Using the 1979–2010 waves of the National Longitudinal Survey of Youth, our study tracks the earnings of individual entrepreneurs from the beginning of their entrepreneurial careers, examining the effects of labor markets on their earnings trajectory. Results show that apart from self-selection, labor markets impose a penalty on the initial earnings of entrepreneurs who start a business in adverse economic conditions, a disadvantage that persist for up to a decade. We also identify two factors expected to alleviate the imprinting effect of labor markets: migration outside the imprinting environment and serial entrepreneurship.

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1. Executive summary

How do the labor market conditions under which entrepreneurs start new businesses affect their initial earnings and future income trajectory? An extensive literature has considered the differential selection of individuals into entrepreneurial activity, often distinguishing between “necessity” entrepreneurs, who lack other viable employment options, and “opportunity” entrepreneurs, who are drawn in by promising ideas or markets (Deli, 2011; Hessels et al., 2008; Reynolds, 2005). What remains missing from these studies is an account of how labor market conditions may impact entrepreneurial performance apart from the self-selection of entrepreneurs. Building on classic and recent theorizing regarding organizational imprinting (Marquis and Tilcsik, 2013; Simsek et al., 2015; Stinchcombe, 1965), we argue that initial market conditions have durable implications for the earnings of entrepreneurs, even when their abilities, demographics, and orientations toward risk are observationally equivalent across favorable and adverse labor markets.

Both individual and organizational mechanisms explain how the imprinting of labor market conditions may occur. First, entrepreneurs who start businesses in areas with high rates of unemployment develop durable preferences and business strategies that emphasize safe returns over greater risk and reward. Second, when initially faced with lackluster consumer demand, entrepreneurs invest in human capital that is tailored to counter-cyclical industries with lower potential for earnings growth. Finally, businesses that are started during economic downturns (or in economically depressed areas) face fierce competition in mainstream markets and move toward more peripheral and inferior niches. Once entrepreneurs lock into these initial strategies, skills, and market positions, they are difficult to change, even when local labor market conditions improve.

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We test the imprinting argument by tracking a large representative cohort of individuals in the United States over a thirty-year period, creating balanced sub-samples of those who start business ventures in adverse labor markets and those who start ventures in favorable ones. Our findings reveal several novel patterns in entrepreneurial entry and earnings over the life course. Differential selection in adverse labor markets is limited to a handful of characteristics, particularly the self-esteem, cognitive ability, and age of entrepreneurs. Adjusting for selection on these and a host of other attributes, entrepreneurs who start businesses in adverse labor markets have much lower initial earnings than those who start businesses in favorable labor markets, with a 10% penalty in business earnings for a 1% increase in local unemployment. Moreover, the penalty persists for roughly ten years, even in the face of changing labor market conditions. The imprint of these initial labor market conditions is reduced or eliminated when they migrate to a different geographic area or when entrepreneurs go on to found new businesses.

By theorizing and qualifying the extent of labor market imprinting, this study moves the analysis of startup performance beyond individual and contemporaneous determinants to enrich our understanding of historical path-dependencies that constrain entrepreneurs. Individuals who have the misfortune of starting businesses during labor market downturns, or in economically-depressed regions, are likely to experience poor performance for years to come.

2. Introduction

Ever since the theory of organizational imprinting was formulated fifty years ago (Stinchcombe, 1965), management scholars have examined how the social conditions that prevail when an organization (or organizational form) is first created continue to affect its structure and performance in subsequent years. As a result, a rich literature has emerged around the imprint of founder identities (Fauchart and Gruber, 2011), hiring strategies (Baron et al., 1999), functional positions (Burton and Beckman, 2007), organizational capabilities (Marquis and Huang, 2010), and favorable or unfavorable conditions at founding (Dobrev and Gotsopoulos, 2010). In the original conception of imprinting, Arthur Stinchcombe (1965: 143–44, 153) was particularly intrigued by the possibility that the structure of labor markets would create a durable correlation between the time and locale in which an organization was founded and its present structure and performance. Yet the management literature provides limited understanding of whether and how differences in labor market conditions contribute to the trajectory of entrepreneurs over time.

The potential importance of labor markets for entrepreneurs does occupy a central place in a distinction between founding activity that is undertaken out of necessity and founding activity that takes advantage of market opportunities (Deli, 2011; Hessels et al., 2008; Reynolds, 2005). Necessity entrepreneurship tends to be pursued when an entrepreneur's other options fail to provide viable or attractive alternatives for employment. The concept thus connects unfavorable labor markets and dismal employment prospects with an increase in startup activity (Lippmann et al., 2005). Opportunity entrepreneurship, on the other hand, describes individuals as entering entrepreneurship to exploit external opportunities. Within this perspective, favorable labor markets (e.g., a low unemployment rate) may act as a "pull" factor that encourages more people to enter into entrepreneurship, especially when these conditions expand consumption for new products and services.

A key problem in this framing is that it emphasizes conditions and effects at the time of business founding, thus ignoring Stinchcombe's imprinting hypothesis. Existing studies generally approach the relationship between labor markets and entrepreneurship from a static rather than imprinting perspective, focusing on cross-sectional labor market data to estimate point-in-time effects of unemployment rates on entrepreneurship (Parker, 2009; Storey, 1991). If imprinting arguments are correct, however, the crucial impact of labor markets may be felt by entrepreneurs many years down the road, when the initial impetus to start a business out of necessity or opportunity bears fruit, as reflected in the capabilities of the founder, the structure and market niche of their enterprise, and, most importantly, entrepreneurial performance.

This study offers a new perspective on the relationship between unemployment and entrepreneurship, expanding recent research on imprinting by focusing on the lasting impact of labor market conditions on the earnings trajectory of entrepreneurs. Consistent with existing perspectives on necessity entrepreneurship, we agree that unfavorable labor markets may pull in individuals who are ill-prepared for business ownership. However, we argue that the lower earnings of entrepreneurs in these contexts are largely the result of sensitivity to initial economic conditions, rather than differences in entrepreneurial quality. The imprint from adverse labor markets persists for about a decade, penalizing earnings over the early history of business startups. We also examine two factors that may alleviate imprinting: moving out of the imprinting environment and multiple instances of entrepreneurship. We test our hypotheses using a longitudinal dataset that spans nearly 30 years and match it to county-level information on unemployment rates, based on the residential location of entrepreneurs from the 1980–2010 Decennial Censuses. Following recent calls for more attention to the mechanisms that generate imprinting (Johnson, 2007; Marquis and Tilcsik, 2013), our findings show that this imprinting effect holds apart from the self-selection of disadvantaged entrepreneurs in adverse labor markets.

3. Theory and hypotheses

3.1. Imprinting the entrepreneurial life course

While early studies of entrepreneurship often focused on instances of startup activity in isolation, more recent theoretical and empirical work has begun to place these instances within the context of the entrepreneurial life cycle (Aldrich and Kim, 2007). The life course perspective recognizes that entrepreneurs may enter or exit startup activity multiple times throughout their careers (Ferber and Waldfogel, 1998; Müller and Arum, 2004), that there may be distinctive career pathways, triggered by varying circumstances and preferences, which lead entrepreneurs into episodes of self-employment (Aldrich and Kim, 2007), and that it is

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