



## Slipping the surly bonds: The value of autonomy in self-employment

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### ABSTRACT

This paper models the tradeoff between increased autonomy from self-employment and the generally higher income that traditional employment offers. While the demand for autonomy is a purely psychological construct, the economic tradeoffs involved in its achievement are eminently amenable to quantification and analytical modeling characteristic of economic analysis. We use this setup to offer a multifactor utility formulation formalizing the notion of an explicit, autonomy-based preference for self-employment. We propose such a formulation as a theoretically-defensible alternative to the classic (and also psychologically-based) overconfidence hypothesis in explaining why self-employment is chosen despite evidence that newly self-employed individuals earn less than comparable individuals who continue their current employment. Our model, founded on utility maximization by a rational individual, demonstrates not only that newly self-employed individuals are willing to accept lower earnings outcomes in exchange for psychic benefits from self-employment, but also that the structure of their optimal launch-timing decision *guarantees* that they will quit at a time such that their income will (at least initially) be reduced. We conclude with implications for the design of empirical instruments to quantify the relative importance of autonomy and income.

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### 1. Introduction and motivation

This paper models the tradeoff between increased autonomy from self-employment and the generally higher income that traditional employment offers. Many new businesses fail shortly after inception (Baldwin, 1995; Dunne, Roberts, & Samuelson, 1988) and entrepreneurship is a career choice that does not, on average, offer improved financial remuneration compared to alternatives. Hamilton (2000) has shown that, except for the highest 25% of entrepreneurial incomes, remaining in a wage-producing job (or moving back to it) makes more economic sense than starting a new business. Thus, utility-maximizing individuals who voluntarily and deliberately switch from employment to self-employment must be gaining *something* in exchange for the income they forgo: the usual explanation is “autonomy.”

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In contrast to offering a clear explanation of autonomy's value, however, some of the work on entrepreneurial motives leads to questions of construct validity about autonomy itself. Invoking an espoused motivation to achieve autonomy as the main explanation of why people want to start their own business (in which they will, presumably, be autonomous) runs the risk of being tautological since, among other things, simply naming "autonomy" as that which is being sought does not explain what its value consists of (van Gelderen & Jansen, 2006; Shane, Locke, & Collins, 2003) or why entrepreneurs are willing to accept less money if they can get more of it. We hope to resolve this apparent circularity by using our model of the value of autonomy to distinguish cause from effect, and to separate the decision to seek autonomy from the utility that results from it.

While this desire for autonomy is a psychological construct, the economic tradeoffs involved in its achievement are eminently amenable to the quantification and analytical modeling characteristic of economic analysis. We use this setup to explain why individuals move to self-employment despite the economic disadvantages of doing so without assuming they are inherently irrational or making a decision error. Our model, founded on utility maximization by a rational individual, not only demonstrates that newly self-employed individuals ought to be willing to accept lower earnings outcomes in exchange for psychic benefits from self-employment, it also shows that the structure of their optimal launch-timing decision *guarantees* that they will choose to quit at a time such that their income will initially be reduced.<sup>2</sup> Our paper contributes to the literature on the psychology and economics of entrepreneurship by providing a formal analysis of potentially self-employed individuals' willingness to trade income for autonomy and, in particular, by showing that the empirically observed shortfall of post-quit income is possible – and, indeed, expected – even when uncertainty or entrepreneurial decision errors are absent. The presence of risk or entrepreneurial overconfidence are normally used to explain why self-employment is chosen even in spite of lower expected returns; our model illustrates that lower income immediately after choosing to enter self-employment is directly implied by rational decision-making and that neither risk nor overconfidence is necessary to achieve the observed empirical facts.

### 1.1. Autonomy and self-employment

Interesting linkages between autonomy and self-employment have been provided by the psychology literature. Breugh (1999) has shown the need for autonomy to be rooted in the desire to decide one's own goals and use of time and, therefore, that autonomy is valued for its own sake. Along similar lines, and building on self-determination theory, Gilad (1982) and Harper (2003) have linked self-efficacy and locus of control to the decision to start one's own business. Amabile (1996) and Corman et al. (1988) have shown intrinsic motivation to be associated to the quest for autonomy and to be related to creativity and the creation of innovative ventures – the intuition being that autonomy provides motivated individuals with more freedom to develop their ideas. In related work, Hyytinen and Ilmakunnas (2006) found that employees who are granted some degree of autonomy, and who can experiment with new things in their present job, consider the content of their work important. Finally, in line with social-cognitive and leadership theories, Baum and Locke (2004) have provided some evidence of a positive relationship between self-efficacy, autonomy and goals of subsequent venture growth.

Also, in spite of past criticisms moved to literature linking personality traits to entrepreneurial inclination, some recent empirical studies rooted in psychology argue that different propensities may facilitate or impede business owners' actions and argue that, as a result, when personality traits are linked to specific tasks, the former become strong predictors of entrepreneurial behavior (Rauch & Frese, 2007). Among these traits, results from Rauch and Frese (2007) have shown the need for autonomy to be associated with entrepreneurs' avoidance of restrictive environments. According to this study, self-employed individuals are individuals who prefer to make independent decisions, set their own goals and develop their own plans. Since individuals with a strong need for autonomy wish to avoid the constraints and rules of established organizations, they are more likely to become self-employed.

The entrepreneurship literature has also produced several empirical papers purporting to show that a desire for autonomy (also referred to as "independence" or "freedom") is an important motivator for choosing to be self-employed (among them are Blais & Toulouse, 1990; Birley & Westhead, 1994; Carter, Gartner, Shaver, & Gatewood, 2003; Feldman & Bolino, 2000; Gatewood, Shaver, & Gartner, 1995; Kolvereid, 1996; Shane, Kolvereid, & Westhead, 1991, 2003).

Overall, empirical evidence to date has shown only that autonomy is somewhat valued by entrepreneurs – that is, that it enters as an argument into their decision process, via which it can be compared against other desirable aspects of their (self-) employment situation – but not how much it is valued. Using data from 23 OECD countries, Benz and Frey (2008a) showed that the self-employed are significantly more satisfied with their jobs than employed individuals, and documented that such higher job satisfaction is attributable mainly to the more interesting jobs and greater autonomy that self-employment entails. Along similar lines, Chirkov, Ryan, Kim, and Kaplan (2003) showed that, across diverse cultures and social practices, autonomy is associated with well-being.

A related empirical regularity – and a corresponding theoretical gap – in the entrepreneurship literature is that prospective entrepreneurs appear to be willing to make tradeoffs between income and autonomy but evidence is lacking on whether these tradeoffs are necessary (or even commonly considered in the decision process). For example, using a sample of 167

<sup>2</sup> An immediate increase in income upon self-employment would imply an unusual cause: for example, (a) the individual getting spectacularly lucky in an unforeseeable way, (b) a previously-binding constraint that prevented self-employment being suddenly lifted, or (c) the launch timing was delayed past the proper time as the result of a decision error (Croson, 2007).

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