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IS THERE A LABOR MARKET ‘PENALTY’ TO ENTREPRENEURSHIP? THE EVOLUTION OF EARNINGS FOR BUSINESS-OWNERS WHO BECOME PAID EMPLOYEES (INTERACTIVE PAPER)

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Principal Topic

To a certain extent, it is expected that individuals are attracted to business-ownership because of higher expected earnings relative to paid-employment; earnings in paid-employment can thus be viewed as an opportunity cost of entrepreneurship. Individuals with relatively low wages are the ones with higher likelihood of switching into self-employment (Evans and Leighton, 1989; Evans and Jovanovic, 1989; Blanchflower and Meyer, 1994). However there may be a mismatch between latent entrepreneurs’ expected utility from business-ownership and their effective earnings once they become business owners. Human capital may play an important role in addressing wage differentials between business-owners and paid employees (Becker, 1975). Recent research has been focusing on the effect of self-employment experience on future wages as paid employee (Williams, 2000; 2003).

Method

The study focuses on male individuals, paid employees and ex-business owners, who are observable in the dataset by 1995 and followed until 2003. Our goal is to ascertain whether business-ownership experience is valued in the labor market or if it is associated with a stigma of failure leading to a negative wage premium. We follow the earnings evolution of former business-owners using a longitudinal matched employer-employee data set. Business-ownership experiences are compared with experiences in paid-employment using wage equations.

Results and Implications

Ex-business-owners face a wage penalty when only individuals’ characteristics are accounted; however, a wage premium emerges when the characteristics of the employing firm are also considered. Accounting for hierarchical levels, ex-business-owners capture a wage premium through better career prospects, as they are comparatively concentrated at the top of employee hierarchies. When controlling for individual heterogeneity with a fixed effects model, results indicate a wage premium to past entrepreneurship experience. The labor market seems to reward former entrepreneurs when the time variation in wages and past experience within each individual is accounted for. This study has important implications for research in entrepreneurship and labor markets, since it represents a novel attempt at gauging the market value of entrepreneurial skills - innate or acquired.

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