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Entrepreneurial beginning, happy ending? Consequences of choosing entrepreneurship to start a professional career.

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Abstract

Title: Entrepreneurial beginning, happy ending? Consequences of choosing entrepreneurship to start a professional career. Name: Adrián L. Mérida Gutiérrez Affiliation: INO, Copenhagen Business School Enrolment date: October, 2014 Expected final date: September, 2018 e-mail: almg.ino@cbs.dk Entrepreneurship is often promoted as an alternative to paid-employment among graduates, not only by policy makers, but also by the universities themselves (Åstebro et al., 2012). Yet the long-term consequences for inexperienced and well educated individuals of beginning their careers through entrepreneurship are unknown. This paper investigates the effects of starting a professional career in entrepreneurship as opposed to paid-employment on lifetime earnings. State-of-the-art: Since the seminal work by Evans and Leighton (1989), a stream of literature on the consequences of entrepreneurial spells for employees when they return to paid-employment has developed,

and positive results are rarely reported. Hamilton (2000) found that, on average, entrepreneurship provides smaller and more volatile earnings that grow at a slower rate than those in paid-employment. If entrepreneurship also yields different initial returns among individuals who have no relevant labor market experience, it might lead to a persistent gap in lifetime earnings. Research gap: We contribute to the literature by providing estimates of the potential effect of starting a career through entrepreneurship rather than through paid-employment on future success –measured as lifetime earnings. Theoretical arguments: Two main mechanisms may explain the potential long-term consequences of starting a professional career through entrepreneurship. The first one relates to human capital accumulation. According to Lazear (2005), entrepreneurs develop a more balanced set of skills while employees accumulate task-specific experience. This suggests that former entrepreneurs may face lower wages when moving to paid-employment. Second, from a wage signaling perspective, it is argued that below-standards wages may be seen by other employers as an indicator of a low quality worker. Thus, an individual who starts in a low-paying job may have difficulties to switch to a better-paid one. This leads to an earnings gap that can last for up to ten years (Kahn, 2010). Thus, if entering the labor market via entrepreneurship provides lower initial earnings, their lifetime earnings would be lower than if they had started directly as employees. However, a successful entrepreneurial experience could mitigate such earnings loss, or even change the direction of the effect. For this reason, this paper also explores the moderating effect of entrepreneurial success. Data and Methodology: We take advantage of the Danish Integrated Database for Labor Market Research (IDA), which allows tracking the career paths and performance of over 76,000 graduates from tertiary education, out of whom more than 1,000 individuals start their careers through entrepreneurship. Our data covers the period from 1981 to 2012. We estimate the difference in the average lifetime income between individuals who started as entrepreneurs and those who started as employees. We address the problem of self-selection into entrepreneurship by following a methodology based on instrumental variables and matching techniques to obtain comparable samples of individuals starting through entrepreneurship and individuals starting through paid-employment. Selection on individuals' unobserved characteristics is addressed with a set of instrumental variables, namely (i) non-parental, non-spouse family entrepreneurship, (ii) rates of entrepreneurial activity in the neighborhood and (iii) rates of entrepreneurial activity among students from the same university. Preliminary results point to a negative effect for those who start as entrepreneurs. Although its magnitude is reduced over time, the effects can last for up to ten years. REFERENCES Åstebro, T., N. Bazzazian, and S. Braguinsky (2012) Startups by recent university graduates and their faculty: Implications for university entrepreneurship policy. *Research Policy*, 41(4), 663-677. Hamilton, B.H. (2000) Does entrepreneurship pay? An empirical analysis of the returns to self-employment. *Journal of Political Economy*, 108(3), 604-631. Kahn, L.B. (2010) The long-term labor market consequences of graduating from college in a bad economy. *Labour Economics*, 17(2), 303-316. Lazear, E.P. (2005) Entrepreneurship. *Journal of Labor Economics*, 23(4), 649-680.

Entrepreneurial beginning, happy ending? Consequences of choosing entrepreneurship at the time of starting a professional career.

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Abstract

Entrepreneurship is frequently promoted as an alternative to paid-employment and unemployment among young individuals. Numerous entrepreneurship education programs have arisen over the last decade in order to incentivize early start-ups among graduates. However, the long-term consequences of starting a professional career through entrepreneurship instead of following the standard entry path through paid-employment are often disregarded. In spite of the evidence that, on average, entrepreneurship tends to provide smaller, more volatile earnings that grow at a slower rate than paid-employment, the situation might be different when the comparison is done between young individuals with no relevant experience who are starting their careers. In this early version of our paper, we discuss several potential channels through which this initial decision may cause a persistent effect on lifetime earnings, such as wage signaling, timing of learning and human capital accumulation. We make use of the Integrated Database for Labor Market Research (IDA) from Statistics Denmark to explore the potential consequences of choosing entrepreneurship at entry in the labor market and to identify the presence of potential moderating factors. Preliminary results from instrumental variable estimations on a matched sample of graduates who start as paid-employees and graduates who become entrepreneurs suggest a negative effect for individuals in the last group. Although the effects seem to vanish over time, the earnings penalty is still significant ten years after entering the labor market.

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