

Non-technical summary

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Human Capital and Entrepreneurship

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Entrepreneurship is a key driver of business dynamism and economic growth and, as such, is of key policy interest. Informed policy decisions require a thorough understanding of the process of entrepreneurship, especially when it comes to barriers that potential entrepreneurs face. One such barrier is the outside option of entrepreneurship: what entrepreneurs could do and how much they could earn if they returned to paid work. Entrepreneurs accumulate business-specific human capital while foregoing human capital accumulation in paid work; therefore, there is reason to believe that the outside option might evolve with entrepreneurship.

Entrepreneurs' options in the labor market, as for any worker, evolve endogenously according to tenure and to the type of activity developed. On the one hand, entrepreneurs accumulate human capital specific to their business while simultaneously foregoing human capital accumulation in paid work. Thus, their paid work-specific human capital stagnates or even erodes while they run a business, which decreases their outside option of returning. On the other hand, their relative disadvantage might diminish if their entrepreneurial human capital can be transferred to paid work. These two forces together determine the endogenous evolution of entrepreneurs' outside option.

We present empirical evidence suggesting that outside options decrease with entrepreneurial experience. We reach these conclusions by comparing the wage trajectories of entrepreneurs who return to paid work (who we term "return-entrepreneurs") with those who never started a business (who we term "never-entrepreneurs").

We find that return-entrepreneurs suffer large and persistent wage losses relative to never-entrepreneurs upon returning to paid work. The immediate wage loss is 18 percent and stands at 5 percent in the long run. Longer entrepreneurial experience is also associated with more persistent losses. Return-entrepreneurs with 5 and 10 years of experience suffer a 3 and 6 percentage point larger wage loss, respectively, than those with only one year of experience. Finally, we find that the losses are larger for more educated people: Return-entrepreneurs without a high school diploma recover to the

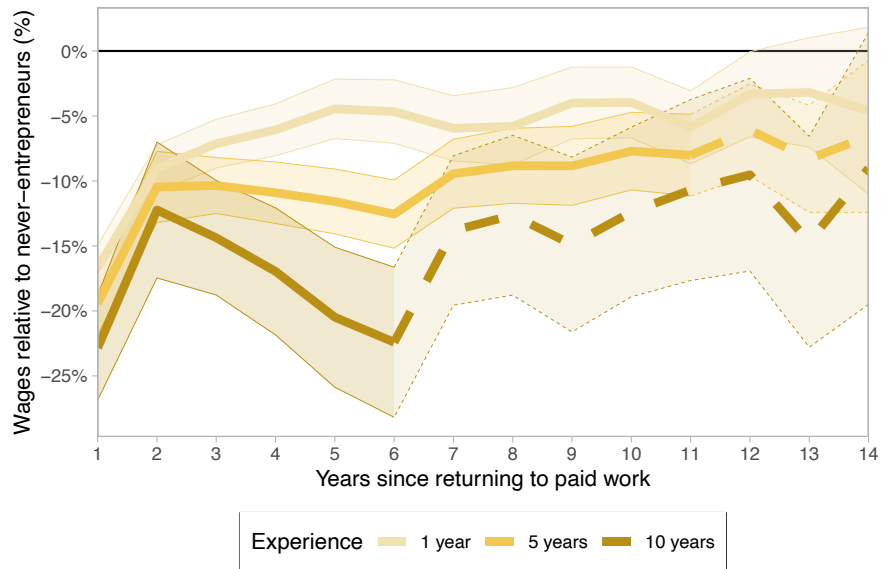


FIGURE 1: Wage trajectories by entrepreneurial experience

Notes: Regression results from specification with occupation FEs. Increasingly darker lines represent wage trajectories after returning to paid work from 1, 5, and 10 years of entrepreneurship, respectively. Shaded regions represent 95 percent confidence bounds. Dashed line segments represent out-of-sample predictions.

Source: QP-SCIE, authors' calculations.

wage level of never-entrepreneurs within 10 years, whereas those with a high school diploma or college degree do not recover within 14 years.

Overall our empirical results suggest that entrepreneurial human capital is specific to business ventures and is not a substitute for human capital gained through experience in paid work.