Entrepreneurial Experience, Regulations and Policy

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ENTREPRENÖRSKAPS FORUM

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Why is Entrepreneurship Important?

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Decades of entrepreneurship research have revealed that development within organizations and societies is fundamentally driven by individuals who possess both the vision to recognize opportunities and the perseverance to implement change. Entrepreneurs play a crucial role as catalysts for innovation and transformation, directly impacting overall efficiency, productivity, and economic growth (Aghion and Howitt, 1992, 1998; Hopenhayn, 1992). Entrepreneurs are pivotal in the creation of new firms, products, and markets, which bring about development (Schumpeter, 1911; 1934). Policymakers want to incentivize individuals to become entrepreneurs, as entrepreneurs contribute to society by creating jobs. Entrepreneurs are not merely individuals who create new businesses; they are problem-solvers and agents of change. Their unique ability to see possibilities where others see challenges allows them to pioneer new products, services, or processes. In doing so, they not only create value for themselves but also introduce innovation that increases competitiveness and spurs further economic activity, contributing to the broader economic system.

Unfortunately, this entrepreneurial spirit and capability are not evenly distributed across the population (Schultz, 1980). Only a small proportion of individuals have the intrinsic qualities – creativity, risk tolerance, resilience, and leadership – necessary to take on entrepreneurial roles. Factors like education, access to capital, social networks, and cultural attitudes toward entrepreneurship also determine who successfully harnesses their entrepreneurial potential. Because not everyone has the same likelihood or capacity to drive change, fostering entrepreneurship is not only about encouraging initiative in individuals but also about building organizational and societal environments that nurture entrepreneurial potential. Supportive systems, such as business incubators, financial incentives, and innovation-friendly regulations, can help level the playing field and allow a broader range of individuals to contribute to development and innovation.

The resilience of a society ultimately depends on interactions between entrepreneurial individuals and the institutional structures that support them (see Parker, 2019, for a discussion). Societies that can effectively tap into the entrepreneurial potential of their population through a combination of individual action and systemic support are more likely to experience sustainable growth, resilience, and adaptability in the face of challenges. The contribution of entrepreneurship to economic growth and other societal benefits depends on the design of both formal and informal institutions. Formal institutions, such as laws and regulations, directly influence entrepreneurs' ability to start firms. Public policy affects not only through legislation but also by signaling the importance of entrepreneurial activities and fostering a culture that promotes innovation and risk-taking. At the same time, informal institutions, like social norms and traditions, play a crucial role in determining how entrepreneurship is valued and utilized within societies. Both formal and informal institutions are essential to enable entrepreneurship to contribute to sustainable growth.

There is not one unified definition of entrepreneurship within the literature. Many measure entrepreneurship as either self-employment through labor market records or new firm formation (Azoulay et al., 2020; Guzman and Stern, 2020; Murphy et al., 1991). This vein of research categorizes owners of incorporated businesses or self-employed individuals who employ others as high-growth, innovation-driven entrepreneurs (Klapper et al., 2015; Levine and Rubinstein, 2016). Other scholars take a more holistic approach and view entrepreneurship as for example, opportunity recognition or the inclusion of paradigm-shifting innovations (Shane and Venkataraman, 2000). Some scholars go so far as to include so-called intrapreneurship, or entrepreneurship within existing organizations (Antoncic and Hisrich, 2001; Martiarena, 2013).

One must be mindful of these varied definitions of entrepreneurship as they affect the interpretation of results and what policy conclusions may be drawn. Although I acknowledge that it is a narrow and rather practical definition, the working definition of an entrepreneur in many of my papers, and in much of this policy brief, is a business owner and particularly that of an incorporated business. This definition tries to capture entrepreneurs who aim to build and grow their businesses to create value and drive change.

To date, studies on entrepreneurship have focused on understanding who starts firms and under what conditions, as well as predicting what makes a successful entrepreneur (see Parker, 2018, for a discussion). In the following chapters, I will first briefly discuss some of the underlying work on how formal institutions affect entrepreneurship, followed by an exploration of the research focusing on the end spectrum of the entrepreneurial process, i.e., what happens after individuals stop being entrepreneurs. Lastly, I will discuss a few aspects of public policy that can be drawn from my work.

What Impacts Entrepreneurship? 2

The general understanding within the academic literature of what shapes new firm formation and individuals' decisions to start new firms is well developed. As the field has evolved, so has the evidence that there are many factors affecting entrepreneurship, both in isolation and interdependently. Instead of being solely interested in the level of entrepreneurship, such as the number of new firms or active entrepreneurs, there is a wide array of evidence showing that there are several factors that affect different types of entrepreneurship, for example high-growth oriented entrepreneurship and sole proprietorship. When we think about the quality of the entrepreneurial endeavor, there are two specific domains that must be considered. The first deals with the selection of ideas and individuals for entrepreneurship. The other deals with understanding what makes a successful entrepreneur post-entry, i.e., post-selection.

Several individual-level determinants, such as education, age, experience, and ability, affect the selection into entrepreneurship (Andersson Joona and Wadensjö, 2013; Åstebro et al., 2011; Levine and Rubinstein, 2016). Many of these same individual-level factors also influence entrepreneurial success (Parker, 2018; Unger et al., 2011). Individuals do not act in a vacuum, however, their environmental and institutional surroundings may also explain why certain people start firms and how they fair as entrepreneurs (Acs et al., 2008; Henrekson and Sanandaji, 2010; Stuetzer et al., 2016). It is not a new insight that entrepreneurs rely on their surrounding market, of which the regulatory environment is an important component.

The dynamism of markets and the number of regulations in place that impede competition vary across contexts and countries (Eklund and Lappi, 2019). Profits that persist for a period of time reveal a lack of competition and imply a systematic misallocation of resources. We empirically show how much European Union countries vary from one another in terms of these profit dynamics both short and long term. We find significant differences in both short and long-term profit persistence, implying that the sources of such systematic differences should be further examined at the national level.

Policymakers and governments adopt and develop different regulations in the face of significant market failures, some of which directly affect competition (Eklund and Lappi, 2018). By focusing on product market regulations that are developed and designed at the national level, we revealed that these regulations lead to persistent abnormal profits for incumbent firms. In other words, having stricter product market regulations can result in decreased competition and larger profits for those firms that are already active in the market.

Alternative sources of government regulations that potentially impact market dynamism come in the form of barriers to entry and market regulations that directly impede competition (Desai et al., 2020). We examined how national-level entry regulations correlate with the existence of firm profit dynamics. When new firms are unable to enter the market due to regulatory restrictions, the incumbent firms are able to extract more profits from their consumers. We found evidence that having more barriers to entry is significantly related to how the market operates, implying that restrictive regulations that hamper entry impact both existing firms and the potential entrants who fail to penetrate the market.

It is not only formal institutions such as government regulations that impact economic activity (North, 1987; 1990). Culture, social norms, and other softer (and more challenging to measure) components of society also impact economic activity and, thus, entrepreneurship. Informal institutions such as social recognition, acceptance of risk-taking and failure, and wealth creation are important determinants of social welfare and growth. The prevailing culture has a long-lasting impact on entrepreneurship (Kleinhempel et al., 2023). Combined with well-designed formal institutions, these persistent cultural roots strengthen the foundation for sustainable productivity growth. Under such conditions, entrepreneurship is channeled toward productive and prosperity-enhancing investments. Conversely, poorly designed institutions can create conditions for unproductive, or even destructive, entrepreneurship (Baumol, 1990).

All institutions, but especially culture, are challenging to measure despite being important for economic growth and entrepreneurship (Acs and Lappi, 2021). We showed that there are underlying differences in the prevalence of different kinds of entrepreneurship based on cultural similarities. The underlying informal institutions steer not only the amount of entrepreneurship but, most importantly, the kind of entrepreneurial efforts individuals engage in. Just as regulations are important for market dynamism, cultural roots are crucial for shaping society's entrepreneurial landscape.

Many factors influence who starts firms and how successful those firms end up being. One important aspect that molds businesses is the institutions and the surrounding environment in general. The role of government and policy is of central importance as they both enable and hinder entrepreneurial opportunities and action. Developing and structuring a well-functioning regulatory environment at both the local and national (and supranational) levels is important for overall productivity, growth, innovation, and employment when entrepreneurship has a central role.

What Happens After Entrepreneurship? 3

Approximately 10 percent of the labor force is actively engaged in business ownership (Hamilton, 2000). However, many of those who are engaged in entrepreneurial endeavors will eventually exit entrepreneurship. Some may try to launch new entrepreneurial ventures and become so-called serial entrepreneurs (Holmes and Schmitz, 1990; Lafontaine and Shaw, 2016; Parker, 2013), while others might decide to retire instead of transitioning to wage employment (Parker and Rougier, 2007). However, wage employment is the most common post-entrepreneurship career path, as approximately half of new entrepreneurs return to traditional employment within seven years (Evans and Leighton, 1989; Kuhn and Schuetze, 2001). The entrepreneurs seem to fare relatively well, as few of them transition to unemployment (Cowling et al., 2004; Hessels et al., 2011).

Many individuals who exit entrepreneurship do so involuntarily; approximately one-fifth of entrepreneurs quit because of bankruptcy, and approximately half quit to take another job (Taylor, 1999). Different individual traits, such as agreeableness or risk tolerance, affect the likelihood that one will leave self-employment (Caliendo et al., 2014). Entrepreneurs without industry experience or who are less educated are also more likely to have an unsuccessful business (Bates, 2005). The underlying reason why an individual started their firm actually predicts their eventual exit route (Rocha et al., 2015). Owning and managing a business is stressful and can potentially lead to negative mental and physical outcomes that may force an entrepreneur to exit the market (Hessels et al., 2018). This vein of evidence points toward a relatively negative view of entrepreneurship, especially the outcome of those who stop being entrepreneurs.

Not all those who leave entrepreneurship are what one would consider failures or are doing so because of bankruptcy (Wennberg and DeTienne, 2014; Wennberg et al., 2010). Only around 10–15% of businesses in the United States that close file for bankruptcy (Baird and Morrison, 2005), and around 40 percent of entrepreneurs who close their ventures define their firm as successful at the time of discontinuation (Headd, 2003). Acquisitions may be considered the most successful type of business exit, but there is only a 5 percent probability of new firms being acquired up to five years after entry (Andersson and Xiao, 2016). Many entrepreneurs exit because they sold their company or received a good job offer and closed down their firm. In this case, it is not the absolute financial performance that is important for exit decisions but an individual-specific threshold level of performance that matters (Gimeno et al., 1997). These findings shed more nuanced light on the exit process, as exiting entrepreneurs are a diverse pool of individuals. This simple fact of diversity is usually neglected both in public discourse and in academic work when discussing entrepreneurial exit.

In fact, entrepreneurs who exit come from both ends of the ability distribution (Andersson Joona and Wadensjö, 2013). Entrepreneurship experience can be thought of as a revolving door; individuals move continuously in and out of self-employment. This means that labor market policy plays a crucial role in the entrepreneurial process, and gaining a deeper understanding of the long-term impact of entrepreneurship experience on individuals, organizations, and even local and national levels is important.

Wages and Career Progression after the Experience

There has been a surge of research evaluating how individuals fare in the labor market once they re-enter the labor force as regular employees following an entrepreneurial experience (Hamilton, 2000; Bruce and Schuetze, 2004; Hyytinen and Rouvinen, 2008; Merida and Rocha, 2021).

Experimentation is vital to the entrepreneurial experience (Manso, 2016), and individuals learn valuable insights from failures (Minniti and Bygrave, 2001). While one would expect that at least some of the skills and knowledge gained during an individual's time as a business owner would be valuable in the labor market, the empirical evidence on how earnings are affected by the entrepreneurship experience has been mixed.

Some have found long-lasting, negative effects of business ownership experience on earnings even after the individual re-enters regular wage employment (Bruce and Schuetze, 2004; Hyytinen and Rouvinen, 2008). Former entrepreneurs also receive fewer callbacks when they apply for jobs (Koellinger et al., 2015) and have a slower overall career progression upon re-entering the labor market (Baptista et al., 2012). These findings point toward a relatively negative view of individuals in the labor market after their experience in entrepreneurship.

On the other hand, there is also evidence showing that those who exit entrepreneurship enjoy positive earnings premiums in wage employment after a spell of self-employment (Evans and Leighton, 1989; Hamilton, 2000). One explanation for these positive earnings premiums is the timing of the experience relative to the individual's career (Merida and Rocha, 2021). More recent studies have found premiums to be connected to industry switching (Kaiser and Malchow-Møller, 2011), firm or individual performance (Luzzi and Sasson, 2016; Mahieu et al., 2021), and for a longer career horizon (Daly, 2015; Ferber and Waldfogel, 1998; Mahieu et al., 2022).

Differences in the use and quality of social networks may also explain why former entrepreneurs earn less than regular-wage employees upon re-entering the labor market as employees (Lappi, 2023). I looked at how having former co-workers at the hiring firm (i.e., having referrals) can mitigate some of the negative stereotypes about entrepreneurship and asymmetric information in the labor market in general. The results showed that having informal ties at the hiring firms correlates with higher entry wages. However, having such a network does not eradicate the negative salary gap between regular-wage employees without entrepreneurial experience and former entrepreneurs.

An alternative explanation for the mixed findings in the previous literature is that the entrepreneurship experience has a differential effect for high- and low-skilled individuals (Lappi et al., 2022). We separately evaluated the earnings of high- and low-educated individuals pre-, during, and post-entrepreneurship experience to a matched group of individuals who did not try self-employment but instead merely changed employers. We found that highly educated individuals have a disadvantage from trying self-employment, whereas self-employment experience might serve as a steppingstone in human capital accumulation and earnings for less educated individuals.

We do not have conclusive evidence on whether or for whom self-employment experience is valuable. Individuals in certain situations seem to be able to mitigate at least some of the adverse earnings and other career outcomes that entrepreneurship entails, for example, staying in the same industry as mentioned before. Although many self-employed individuals report higher levels of happiness and overall job satisfaction (Blanchflower and Oswald, 1998), it seems to come at the cost of long-term career outcomes if one returns to wage employment.

Organizational Outcomes When Hiring Former Entrepreneurs

Recently, the academic focus has shifted from evaluating the individual-level consequences of entrepreneurship experience to the organizational-level consequences of hiring such individuals. Evidence suggests that firms generally do not view hiring former entrepreneurs positively as employers expect former entrepreneurs to be a worse fit for and less committed to the firm (Kacperczyk and Younkin, 2022). The characteristics of the recruiter, however, may matter in how a former entrepreneur is perceived in the recruitment process (Ding et al., 2023; Feng et al., 2024; Kacperczyk and Younkin, 2022; Küsshauer and Baum, 2023). This emergent evidence implies that one of the reasons former entrepreneurs have earnings losses relative to regular employees is that firms evaluate them differently, regardless of what knowledge they may have gained during their experience.

If former entrepreneurs indeed perform worse and are less productive, it should be apparent when we evaluate the impact of hiring different kinds of workers and how these workers relate to instantaneous productivity gains/losses within the firm (Lappi, 2024). I looked at different knowledge flows at the firm level to evaluate how hiring different types of employees translates to firm productivity. It usually takes some time for a new employee to contribute to the firm's productivity as they learn new organizational routines and work with new people. I found that former entrepreneurs have the same first-year adjustment costs as any regular wage employee. Several years after hiring, very skillful former entrepreneurs are a source of large productivity improvements. The results imply that former entrepreneurs are not, in general, less productive than employees who do not transition from business ownership, despite earning less.

There are several reasons to expect that former entrepreneurs create a positive impact as employees. For example, having co-workers who are former entrepreneurs can create knowledge externalities and lead individuals to pursue more entrepreneurial opportunities (Nanda and Sørensen, 2010). Former entrepreneurs may also lead to more innovation within a firm as they can transfer their innovation capabilities and ideas to their colleagues and work-place (Lindbjerg and Vladasel, 2021). Having employees with entrepreneurial experience can bring organizational improvements through knowledge externalities they create and direct improvements resulting from the new skills and knowledge they bring to the organization.

Former entrepreneurs can also be a source of strategic and complementary human capital that firms can acquire and use in their production process (Braunerhjelm and Lappi, 2023). We found that having employees who have been entrepreneurs is associated with higher firm productivity over the long term, although there are many contingent factors, such as entrepreneurial success and the ability of the individual. In other words, we show that former entrepreneurs can be a source of improved organizational performance that has long-lasting implications for productivity.

Taking the positive organization-level findings together with the individual-level findings makes the situation even cloudier. What is going on? The revolving door of entrepreneurship seems to be good for firms, yet they do not pay for these gains. There appears to be a discrepancy between who bears the cost of experimentation and innovation. Should public policy intervene?

What Should We Learn from All of This? 4

What have governments done to promote entrepreneurship? In Sweden (as in many industrialized countries), the answer is quite a lot. Some of my research has shown that regulating markets is associated with greater profits for incumbents and less innovation and entrepreneurship. Showing that regulations come at a cost is not a new finding; most of the time, these costs are completely justified. However, there are possible reasons to intervene, such as when significant externalities or asymmetric information are present. In a world with already existing regulations, we should also think about the low-hanging fruit of deregulation or, at a minimum, shaping regulations to do the least unintended harm. On a grander scale, we can even consider opportunities to experiment with policy. Entrepreneurship is a phenomenon that has both direct and indirect (long-lasting) effects not only on individuals but also on innovation, technology, and growth, and hence, many policy spheres have implications for entrepreneurship. Below, I discuss four major policy areas drawn from the implications of my previous published work, though I acknowledge other areas, such as housing or healthcare policies, also impact entrepreneurship.

Labor mobility is key. Labor mobility and trying out different kinds of labor market experiences are generally good for growth and innovation. Strict labor laws impede experimentation with different organizations and labor market experiences. There are examples of flexitarian social welfare systems with well-functioning unemployment benefit systems, such as Denmark, where individuals can switch employers or experiment and become entrepreneurs without excessive risk of income losses if the job switch does not pan out. Ensuring access to lifelong learning through courses and other training would also enable more experimentation in the labor market and potentially bring more innovative ideas to the market.

Perceptions about entrepreneurship. Does policy impact the stigma of failure or the culture surrounding entrepreneurship? If firms do not want to offer higher wages to former entrepreneurs, should we try to change that? Governments probably cannot do much in these cases. They can, however, make hiring (new) employees cheaper, which would make hiring former entrepreneurs less risky. Decreasing the risks associated with hiring new employees, in general, should lead to employers experimenting with different kinds of employees, including those typically perceived as more risky, such as former entrepreneurs.

Incentivizing the right kind of entrepreneurship. The capital requirements for starting and managing a firm in Sweden are low, and the financial market generally works relatively well. Subsidies that incentivize research and development should be cautiously designed so that they are not only cash transfers to larger corporations. Similarly, how to structure labor market programs that incentivize inactive or unemployed individuals should be revisited as these individuals might bear a cost associated with self-employment experience if they transition to wage employment afterwards.

Policy experimentation. One-size-fits-all entrepreneurial policies are likely to result in unpredictable consequences affecting not only the types of firms created but also individuals' earnings, career outcomes, and health outcomes in the long run. In a small, open economy where policy is relatively close to the general public and businesses, there is ample room to conduct research-based experiments on different industrial policies to determine which policy instruments work best in the Swedish context. Conducting such policy experiments would also increase scientific knowledge beyond the Swedish context and inform policymakers abroad.

There are many other aspects influencing entrepreneurship that public policy should try to tackle, as entrepreneurship plays a pivotal role in shaping economic growth, innovation, and societal dynamism. However, the processes surrounding entry, persistence, and exit from entrepreneurship are complex and multifaceted. While regulatory environments that foster fair competition and lower barriers to entry are critical in encouraging productive entrepreneurship, the nuanced effects of informal institutions, such as cultural attitudes toward risk-taking and innovation, further highlight the need for context-specific policies. Policymakers should prioritize creating ecosystems that not only increase the number of entrepreneurs but also enhance the quality and sustainability of entrepreneurial endeavors.

Post-entrepreneurship transitions reveal a mix of challenges and opportunities for individuals and organizations. Former entrepreneurs often face career disadvantages and earnings losses when re-entering wage employment despite the skills and knowledge they gain during their ventures. Paradoxically, organizations that hire former entrepreneurs often benefit from enhanced productivity and innovation, suggesting an asymmetry in the distribution of the costs and benefits of entrepreneurial experimentation. To bridge this gap, public policy can play a role in mitigating risks for entrepreneurs while incentivizing firms to recognize and reward the unique contributions of entrepreneurial experience. By aligning individual and organizational incentives and addressing systemic disparities, governments can enhance the long-term benefits of entrepreneurship for individuals, firms, and society as a whole.

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