To be or not to be ... An entrepreneur

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Credit: University of California - Berkeley

Today, more and more self-employed business owners may call themselves entrepreneurs, a label that connotes creativity, innovation, and success.

But not all business owners are alike.

Prof. Ross Levine found evidence that a company's legal status—incorporated or unincorporated—can be used as a reliable

measure to distinguish entrepreneurs from other business owners. By identifying this distinction, the research shows that incorporated business owners open companies that are entrepreneurial and require high-level cognitive skills. On the other hand, unincorporated business owners tend to lead companies that demand more manual talents.

The findings are detailed in "Smart and Illicit: Who Becomes An Entrepreneur and Do They Earn More?," forthcoming in the *Quarterly Journal of Economics* and co-authored by Levine, a professor of economics at UC Berkeley's Haas School of Business, and Yona Rubinstein, a professor at the London School of Economics and Political Science.

Their latest study is part of a larger body of work aimed at defining the key characteristics of entrepreneurs, and how to predict their success beyond a one dimensional definition of self-employment.

Levine and Rubinstein determined that self-employment status alone does not provide an adequate measure for studying entrepreneurs. Instead, they differentiated between two types of self-employed business owners: owners of incorporated businesses and owners of unincorporated businesses.

A typical example of an entrepreneur or incorporated business owner might be the founder of a digital advertising agency or a mobile app startup. Another type of business owner may be an unincorporated plumber, contractor, or cleaning person.

"When people think of entrepreneurs, they think of somebody creating something novel, something nonroutine, something risky, and cognitively challenging," says Levine. "We found that people who open such businesses tend to open incorporated businesses. In contrast, when people open businesses that perform fairly routine activities, the

founders tend to have less formal education and open unincorporated businesses."

An incorporated business benefits by limited liability and a separate legal identity. Armed with that protection and less financial exposure, owners of incorporated businesses tend to venture into larger and riskier investments than their unincorporated counterparts.

This differentiation allowed the authors to determine which type of business owner is financially more successful.

Levine and Rubinstein used data from the Current Population Survey (CPS) for the period between 1995 and 2012 and the National Longitudinal Survey of Youth (NLSY79), a survey of 12,686 people who were 15 to 22 years old when they were first surveyed in 1979. Each participant was surveyed annually through 1994 and biennially ever since.

The study found that prior to launching their own companies, incorporated entrepreneurs 1) exhibit greater self-esteem; 2) want to be more in charge of their own futures; 3) engage in more illicit, break-the-rules type of activities than others; 4) are usually involved in jobs that primarily rely on intellect; and 5) are more likely than salaried workers to come from high-earning families with two well-educated parents. And before working at all, the entrepreneur scored high on learning aptitude test and engaged in more illicit, risky activities such as cutting classes, vandalism, shoplifting, gambling, assault, and using alcohol and marijuana. These "smart and illicit" entrepreneurs, who tend to be white males, full-time workers, and 25 years or older,are also twice as likely to launch an incorporated business than others who open businesses.

Meantime, unincorporated business owners tend to 1) have responsibilities that require more manual skills, and 2) were previously

employed in similar work.

Incorporated entrepreneurs are also more likely to have many employees while unincorporated business owners have few or no employees. And they earn more than unincorporated business owners. According to the study, this group reported an increase of $6,600 in median annual earnings when they became entrepreneurs relative to their previous salary; that compares to a mere $716 increase for those not demonstrating the common traits of an entrepreneur.

The analysis also revealed that incorporated business owners had higher salaries before they became entrepreneurs than unincorporated owners who typically held lower paying jobs. Those who switched from a salary job to unincorporated self-employment earned only 85 cents on the dollar compared to when they worked for someone else.

The research findings appear to mirror how many business owners already think of their roles.

"We found that over time incorporated business owners are more likely to describe themselves as "entrepreneurs" than unincorporated business owners," says Levine.

See paper:
http://faculty.haas.berkeley.edu/ross_levine/Papers/SMARTANDILLICIT.pdf

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