Leaving Scylla to meet Charybdis? Choosing entrepreneurship over salaried work when in poverty

precarious work, self-employment, working poor, low wage, opportunity self-employment

L26; I31; J21

Extended Abstract

On average, entrepreneurial earnings are lower compared to salaried work. Though it could partly be explained by income underreporting (Åstebro & Chen, 2014), this is also related to selection effects, with "stars and misfits" especially drawn to entrepreneurship. Income distribution in entrepreneurship appears highly polarized (Levine et al., 2017) and volatile (Schneck, 2020). Without surprise, poverty rates among entrepreneurs are higher than among workers for wages.

This gives out the idea of limited or negative financial payoffs for most entrepreneurs, and especially for the most vulnerable ones.

Part of the literature highlights a trade-off between monetary and non-monetary gains (Benz & Frey, 2008; Shir et al., 2019) making entrepreneurship still attractive; individuals may choose entrepreneurship for features improving their well-being (autonomy, flexibility…) and accept lower income in return. However, these results might not apply to the poor because they usually cannot afford to earn less and are more likely to suffer high failure costs – financial, psychological and social – if entrepreneurship doesn't work out for them (Fairlie & Robb, 2008; Morris et al., 2022; Ucbasaran et al., 2013).

Despite these constraints, the poor are also more likely to enter entrepreneurship (Acs and Kallas 2008; Barr 2008; Slivinski 2012) and the poor entering self-employment are a specific socio-demographic population, with a distinctive entrepreneurial experience. More specifically, Morris et al. (2022) demonstrate that those who are already in poverty face specific disadvantages and fragility when entering entrepreneurship, a "liability of poorness". Among other things, it makes their business survival rate lower. This would also be coherent with an overexposure to the most precarious self-employment settings (Reuschke & Zhang, 2022; de Vries et al., 2020; Schulze Buschoff & Schmidt, 2009; Zwick, 2018), though the literature rarely explicitly connect those situations with past poverty.

Despite these results, academic literature gives out ambiguous insights on entrepreneurship capacity to represent a pathway out of poverty (Amorós and Cristi 2011; Bruton al. 2013; McMullen 2011; Slivinski 2012; Kimmittet al. 2019). Entrepreneurship could be especially efficient when targeted policies are well designed (Morris et al., 2020).

Indeed, several studies show that the poor can launch successful businesses allowing them to escape poverty and become less dependent on public and private help (Amorós and Cristi 2011; Abraham 2012; Clark et al. 1999; Edelman et al. 2010). In case of successful entrepreneurial experience, individuals could benefit from new skills and higher well-being (Shantz et al. 2018), opening new employment opportunities.

Some of the ambiguity might be related to past employment trajectories, and it appears especially important to distinguish individuals who are choosing self-employment to escape unemployment from those who are using self-employment to leave a salaried position that does not meet their needs or expectations. This necessity/opportunity distinction (Auguste et al., 2023; de Vries et al., 2020; Dvouletý & Lukeš, 2016; Reuschke & Zhang; strongly differentiates socio-demographics (Winckel and Lewin, n.d.; Fisher et al, 2024; Patrick et al., 2016) and influence business success (de Vries et al. (2020).

Finally, rare research focusing on the working poor show that their entrepreneurial payoffs are generally negative (Fisher et al., 2024). These results, however, don't account for employment duration and its effects on payoffs and thus does not discriminate between individuals who manage to keep their business for several years or failed.

We seek to address these ambiguous or pending results by focusing on individuals leaving a stable salaried position (two years or longer) to enter self-employment and study how poverty status impact their entrepreneurial payoff.

The following questions are investigated:

1. Are levels of payoff different across households' level of wealth or poverty?

2. How do payoffs evolve over time?

3. Does long-term entrepreneurship provide positive payoff for the wage-earning poor?

We hypothesize that:

1) Entrepreneurship payoffs strongly vary depending on previous wealth and poverty status.

2) The wage-earning poor are already experiencing the effects of precariousness, at least financially. The relative drop in income when entering self-employment is thus lower than for wealthier individuals.

3) The wage-earning poor managing to stay in self-employment for a long time have overcome some of poverty liabilities. Long-term entrepreneurship can thus pay off for the poor.

To clarify entrepreneurship's monetary payoff across poverty status, we focus on a specific category of individuals belonging to the working poor in the long-term (two years or more). This group has sufficient capital and skills to be in stable employment but remains in poverty despite existing labor income. This study investigates the outcome of their decision to stay workers-for-wages or leave for self-employment. We conclude if this leap of faith pays off financially, or not.

To that end, we use heterogeneous difference-in-differences. This technic has known strong development recently (Callaway & Sant'Anna, 2020); it provides elegant results despite numerous limitations (Baker et al., 2022). The "treatment" considered is the transition from work-for-wages to self-employment.

Our model is tested on data from the Panel Study of Income Dynamics (PSID). It is conducted on Americans households every two years, but provides a continuous work history. For data consistency issues and to gather a sufficient sample size, the study focuses on the period from 2003 to 2021.

Five cohorts are studied (2007; 2009; 2011; 2013; 2015) across different self-employment duration (0; 2; 4; 6 years). Two subsamples are considered among individuals coming from salaried work according to their poverty status during the pre-treatment period. Only individuals constantly in or out of poverty during the two pretreatment years were considered, to remove stochastic poverty out of our sample.

We test several dependent variables, such as the total labor income (encompassing wages and self-employment earnings) corrected from inflation and the number of hours worked during the year.

Results show that entrepreneurship payoffs appear negative across poverty status. This is partly related to the drop in earnings during the first few years of self-employment and the fact that young business failure rates are usually high.

The relative drop in income when entering self-employment is lower for individuals in poverty compared to wealthier individuals. This lower opportunity cost for self-employment is related to structurally lower wages for the working poor before transition. However, the average treatment effect highly varies between cohorts in the poor sample, revealing how much business success is sensitive to economic cycles. This matches previous research showing that individuals have very different employment trajectories across the economic down- and upturns depending on their poverty status.

Finally, it appears that the average effect of switching to self-employment over time is rarely statistically significant for the poor sample. After six years of self-employment, the payoff is only slightly negative, but this average probably hides great discrepancies within the poor subsample. By contrast, wealthier individuals have significant and clearly negative average effect of self-employment of any duration.

On average, long-term self-employment still has a negative impact on labor income, whatever their poverty status before entering self-employment. This makes entrepreneurship as a strategy to get higher labor income and leave in-work poverty that way highly inconclusive. The sensitivity of the entrepreneurial poor labor to economic downturns makes cyclical policies essential to support entrepreneurs. However, it appears that in work poverty is more of a problem than entrepreneurial failure for these populations, making structural policies toward labor markets, education and social security more interesting than tailored entrepreneurial programs targeting the poor.

Further investigations are needed to understand if the working poor benefit differently from non-monetary gains compared to wealthier individuals and how it influences their self-employment experience. For instance, self-employment might be a way to manage work with other constraints like health issues or daycare. Keeping a paid activity could be a way to avoid falling deeper into poverty.

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recently (Callaway & Sant’Anna, 2020), but also present numerous limits (Baker et al., 2022).

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