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The good, the bad, and the talented: Entrepreneurial talent and selfish behavior

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ABSTRACT

Talent allocation models assume that entrepreneurially talented people are selfish and thus allocate into unproductive or even destructive activities if these offer the highest private returns. This paper experimentally analyzes selfish preferences of the entrepreneurially talented. We find that making a distinction between *creative* talent and *business* talent explains systematic differences in selfish behavior. Generally, both the less business-talented and the more creative are more willing to forego private payoffs to avoid losses to others. A moderator analysis reveals that less creative individuals with business talent are significantly more selfish than all others, including the creative with business talent. This finding applies to both certain and risky payoffs with and without negative externalities. The paper makes a contribution to entrepreneurship research by qualifying the implications of talent allocation models and highlighting the importance of distinguishing between the two types of entrepreneurial talent. We also add to the field of experimental economics by advancing research on altruism under risk and with negative externalities.

1. Introduction

Traditionally, entrepreneurship is thought to have positive effects on economic growth and welfare. However, since the early 1990s, several theoretical papers have challenged the longstanding notion of the 'productive entrepreneur' and stress the importance of building appropriate institutions and incentive schemes to channel entrepreneurial activity. For example, in his seminal paper, Baumol (1990) posits that entrepreneurship is not necessarily productive; it can be just the opposite

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and can also take unproductive and even destructive forms. He notes that entrepreneurs act in ingenious and creative ways to increase their wealth, power, and prestige and not always with consideration of the effects their activities have on others and/or the economy as a whole.[1]

Essentially, Baumol (1990), Murphy et al. (1991, 1993), Acemoglu (1995), Mehlum et al. (2003), and others argue that entrepreneurial talent allocates into activities “with the highest private returns, which need not have the highest social returns” (Murphy et al., 1991, p. 506). Most models of talent allocation assume a fixed pool of one-dimensional entrepreneurial talent that chooses between productive activities (e.g., starting firms that innovate and foster growth) and unproductive activities (e.g., by redistributing or destroying wealth and reducing growth).[2] This choice is modeled to depend entirely on private payoffs. If unproductive activities offer more rewards than productive activities, talent allocation models assume that entrepreneurial talent chooses the former, despite possible negative externalities for others or adverse effects on economic growth.[3] Hence, common to talent allocation models, and a central assumption in the corresponding literature, is that entrepreneurial talent is not altruistic but selfish. This is the key hypothesis that we test in this paper.

It has long been held in experimental economics that people do depart from pure self-interest and that they vary in their degree of selfishness across individuals. In the economic literature, these preferences are mostly discussed under the rubric of benevolence or altruism (see e.g., Trivers, 1971; Brennan, 1975; Becker, 1976; Bester and Güth, 1998; Andreoni and Miller, 2002). Sometimes they are thought to be better construed as fairness or inequity aversion (Bolton, 1991; Fehr and Schmidt, 1999; Bolton and Ockenfels, 2000). For an overview see Daruvala (2010). In this paper we use the term ‘altruism’, or ‘selfishness’ for the opposite. The overwhelming majority of these studies focus on sure payoffs. Entrepreneurial decisions, however, also involve risk, and recently there has been some attempt to investigate the propensity to take a risk when this affects others. Brennan et al. (2008) and Güth et al. (2008) provide first empirical results on this type of ‘social risk taking’. Their major finding is that risk to others appears much less important than own risk, even for those with altruistic preferences. Güth et al. (2008) explain this result by suggesting a cognitive “crowding out” of altruistic preferences by own risk. If people are occupied with considerations about their own risky payoffs, they ignore others’ well-being, even though they are more altruistic in other situations involving less risky payoffs for themselves. In a related study, Bolton and Ockenfels (2010) analyze the effect of social comparison and relative standing on risk taking. Their results suggest that decision makers tend to be more risk averse when their decisions affect others, but less risk averse when the safe option implies an unfair outcome. In fact, unfair outcomes seem to be more acceptable when they are due to chance. Bradler’s (2009) results corroborate this, but she also finds that altruism is not necessarily “crowded out” by own risk, as people prefer fair outcomes even when they are more costly in the sense of more risk. In summary, experimental evidence shows that, in contrast to the assumptions of most talent allocation models, altruistic preferences constitute an important element in human decision-making, in particular when payoffs are certain, but also under risk.

Although studies in experimental economics have not yet explicitly linked altruism to entrepreneurial talent, the notion that entrepreneurial talent may be less selfish than assumed by Baumol (1990) is widely recognized in the entrepreneurship literature, particularly in the field of social entrepreneurship. For example, Zahra et al. (2009, p. 5) define social entrepreneurship as something that “encompasses the activities and processes undertaken to discover, define, and exploit opportunities in order to *enhance social wealth* by creating new ventures or managing existing organizations in an innovative manner” (emphasis added). Bornstein (2004) provided supporting evidence for the importance of social motivations in entrepreneurship. Hence, in the field of social entrepreneurship, altruistic preferences are considered to play a dominant role.

If we accept, based on the above-mentioned literature, that altruism plays a role in human behavior, this can have important implications for entrepreneurship policies. In most talent allocation models, incentive systems and institutions determine the private costs and benefits of the different types of activity. Consequently, institutions are considered to determine the allocation of entrepreneurial talent. Since externalities can create market failures in allocating entrepreneurial talent, institutions need to internalize these externalities to ensure welfare maximization (Baumol, 1990). If altruistic preferences internalize some of these externalities, then less policy intervention will be needed. If the entrepreneurially talented are more altruistic than the less talented, the allocative function of formal institutions risks being too restrictive and might even hinder the selection of appropriate individuals into productive ventures. In an extreme case such institutions might even crowd out intrinsically motivated altruism (e.g. Frey, 1997; Frey and Oberholzer-Gee, 1997). If, on the other hand, entrepreneurial talent is negatively correlated with altruism, strong formal institutions will be needed to internalize negative externalities.

It is not a given, however, that altruism always improves the allocation of talent. Evidence shows that community standards or altruism can also explain market anomalies with suboptimal resource allocations (Kahneman et al., 1986a,b). Within the pool of entrepreneurs, for example, it is possible that altruistic preferences allocate the less talented into social

[1] Here, Baumol (1990) refers to a range of activities that threaten productive entrepreneurship (for related work, see Nunn, 2007; Murphy et al., 1991, 1993; Grossman and Kim, 1995). One example is innovation in rent-seeking procedures, such as “a previously unused legal gambit that is effective in diverting rents to those who are first in exploiting it” (Baumol, 1990, p. 897).

[2] Murphy et al. (1993) separate rent-seeking from entrepreneurship by definition. In this paper, we use the broader Baumolian (1990) definition of entrepreneurship that includes rent-seeking activities.

[3] Similar models also offer a more general economic explanation for crime (e.g. Becker, 1968; Ehrlich, 1973) and for violent conflicts (so-called predator–prey models by Hirshleifer, 1987; Bates et al., 2002; Neary, 1997; Skaperdas, 1992).