

# Employment or self-employment A dynamic utility-maximizing model

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## Abstract

This article presents a dynamic utility-maximizing model of career choice between self-employment and employment that takes into consideration the differences among people in terms of their initial attitudes toward job attributes and the likely changes to those attitudes as they mature. These differences between people affect the choice of career that maximizes their utility (there are at least five optimal career paths). This dynamic utility-maximizing model helps increase our understanding not only of why some people become self-employed but also of why and when some self-employed people switch to employment. © 2001 Elsevier Science Inc. All rights reserved.

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## 1. Executive summary

The considerable literature on careers focuses almost exclusively on job mobility patterns within and across established firms and has all but ignored self-employment. This is

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surprising, as self-employed persons represent a substantial portion of a country's labor force. This article presents a dynamic utility-maximizing model of career choice between self-employment and employment. The model builds on previous economic models that suggest that jobs differ in income, work required, risk involved, and independence allowed (especially between self-employment and employment). People are believed to differ in their attitudes to these job attributes, which helps explain why some people choose to be self-employed while others choose to be employed. While research in this area has increased our understanding of career choice involving self-employment, most of it has implicitly assumed that a person's attitudes to these job attributes are constant.

But, research on life cycle and career stage models has indicated that as people age (mature), their attitudes change. We argue that changing attitudes towards income, work, risk, and independence, as well as changing abilities to complete tasks, affect career choices. We provide a dynamic model of career choice that takes these changes into consideration. Specifically, we present five optimal career paths, depending on the individual's initial utility for self-employment over employment, initial utility associated with the perceived maximum difference in income between self-employment and employment, marginal reduction in utility for self-employment over employment from aging, and final utility for self-employment over employment. For example, one group of people with similar attitudes and maturation processes may derive most utility from beginning their careers in employment, shifting to self-employment for the middle stage of their careers, and then shifting back to employment for the final stage; another group may derive most utility from being continuously employed.

This article makes a step towards increasing our understanding of why and when people become self-employed or switch back to employment. We argue that this is due, in part, to people's attitudes (their utility or disutility weights) and that these attitudes change over time. However, since attitudes can be changed by factors other than time — for example, education or access to resources — there is much interesting research that still needs to be conducted.

## 2. Introduction

Stevenson and Jarillo (1990) propose that entrepreneurship research can be classified into *how* entrepreneurs act (i.e., what it is they do), *what* happens when entrepreneurs act (i.e., what are the outcomes of their actions), and *why* people choose to act as entrepreneurs (i.e., what motivates them). Economic theory has been used in the entrepreneurship domain primarily to investigate what happens when entrepreneurs act and how they do it (Herbert and Link, 1988; Barreto, 1989) — the first two classifications of entrepreneurship research. While there is a considerable literature on career choice from a variety of disciplines (e.g., labor economists, organizational behaviorists, and sociologists), the focus has been almost exclusively on job mobility patterns within and across established firms (Borjas, 1986; Carroll and Mosakowski, 1987). Only recently have scholars turned their attention toward an economic perspective on why people choose self-employment.

Baumol (1990) suggests that people are motivated by the reward structure in the economy — the rules of the game that govern the payoff. Campbell (1992) proposes that the payoff can be evaluated using an expected net present value (ENPV) and that a person will be motivated to be

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