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Inequality and entrepreneurial thresholds

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ABSTRACT

We explore the relationship between inequality and entrepreneurial activity. Drawing on cross-sectional data from a largescale survey of the economic conditions of individuals across India, we develop a number of dimensions of inequality to explore empirically how inequality interacts with entrepreneurship, operationalized as self-employment or as employing other people. We find compelling evidence that there are thresholds to becoming self-employed, and even more so to assembling the combinations of resources and personal attributes required to become an employer. Greater inequality leaves more people unable to make the transition to self-employment, leaving casual laboring as the occupation of necessity. At the same time, inequality increases the number of employers in a society, by concentrating resources - particularly land and finance - enough for significant numbers of people to be able to cross this higher threshold. Lastly, greater differentiation into social or religious groups curtails the ability to cross either entrepreneurial threshold, presumably by limiting the extent and benefits of social networks of value for entrepreneurship.

Executive summary

One of the most important questions in the literature on business venturing is why some people become entrepreneurs while others do not. Largely missing from this research is a discussion of the links between entrepreneurship and inequality. Our key idea is that there are thresholds to becoming self-employed, and even more so to pulling together the combinations of resources and personal attributes required to become an employer. Greater inequality leaves more people unable to make the transition to self-employment, leaving casual laboring as the occupation of necessity. This same inequality increases the number of employers in a society, by concentrating resources – such as land or finance – enough for significant numbers of people to be able to cross this higher threshold. These entrepreneurs are not simply born, they are created.

We test our hypotheses linking inequality with the propensity to be self-employed, or an employer, using data from the 68th round of the Socio-Economic Survey of households, conducted by the National Sample Survey Office (NSSO) of India between July 2011 and June 2012. The survey sampled 101,724 households, encompassing 456,999 individuals. Of these, 134,665 were working, and this is the subset of interest to us: 23% worked for a regular wage, 36% earned wages from casual labor, 40% were self-employed, and 1% were employers.

Based largely on estimates of logistic equations relating employment status to measures of local inequality, we find that, at the

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broadest level, greater inequality appears to favor the formation of employer-owned firms, while for the most part reducing the extent of self-employment, after controlling for other relevant influences on entrepreneurship.

There appear to be two thresholds, one representing a move into self-employment, and the other reflecting the jump to employer status. Crossing these thresholds—being self-employed or an employer—involves assembling combinations of resources, such as education or money, and personal attributes, such as social status, religious affiliation, gender, or family size, that can sustain entrepreneurial action. The combinations available to some individuals may simply be insufficient to cross one or both thresholds. Specifically, there is a large set of people – whom we can call the very poorest – that have difficulty crossing the first one: they lack the land (in rural areas), education, networks, and financial resources required to be sustainably self-employed, and fall back on casual wage laboring. Moreover, inequality worsens this situation by leaving more people in poverty, where self-employment is out of reach; and greater social heterogeneity (as measured by either caste membership or religious affiliation) makes it even harder to develop robust social networks that can help cross the threshold to self-employment.

The second threshold, from self-employed to employer, remains a formidable barrier. The qualitative leap that is needed requires considerable personal and household resources, and in an emerging economy such as India, this is easier to achieve if there is considerable inequality, in effect concentrating enough resources and capacity in a smaller set of individuals to permit the emergence of a class of employers.

The paper makes five contributions. First, at a theoretical level, we show that inequality affects entrepreneurship by altering the proportions of those who are able to cross the first threshold into self-employment, and the second and much higher threshold into becoming an employer. Second, we construct a variety of empirical measures of inequality, which allows us to test the proposition that these affect entrepreneurship, after controlling for other standard variables, in subtler and more complex ways than simply inequality in income levels. Third, we estimate the relationships between inequality and the propensity to entrepreneurship. The results are striking: greater inequality in the distribution of resources is associated with a higher propensity to be an employer, and a lower likelihood of being self-employed. This leads us to conclude, as our fourth contribution, that it is essential to retain the distinction between employers and the self-employed – they cannot simply be lumped into a single class labelled "entrepreneurs – and it also leads us to question the usefulness of the concept of 'necessity entrepreneur'", since it would appear that becoming an entrepreneur requires an act of volition, and is not generally the option of last resort. Fifth and last, our work offers a number of policy implications. The most obvious is that the continuing expansion of education will, for the foreseeable future in India, help increase the number of employers. Moreover, social norms about caste and gender in India appear to be holding back entrepreneurship; thus, measures that weaken caste and gender barriers would favor entrepreneurship. A land reform that would create greater equality in land holdings would have no impact on urban entrepreneurship, but it would increase the number of self-employed in rural India. Lastly, helping the poorest will require a wider menu of interventions, although greater entrepreneurial activity would certainly help this group indirectly insofar as it would boost economic growth and create more jobs.

1. Introduction

One of the most important questions in the literature on business venturing is why some people become entrepreneurs while others do not. The voluminous literature on the subject has mainly focused on personal and household factors such as education and inherited wealth, and on some institutional variables such as measures of the rule of law.

Largely missing from this research is a discussion of the links between entrepreneurship and inequality. Inequality of income is rising in most rich countries (Piketty, 2013), and some believe that it is acting as a brake on economic growth by increasing financial fragility, stalling improvements in health and education, and causing "investment-reducing political and economic instability" (Ostry et al., 2014, p.4). Yet it is also possible that inequality may affect economic growth by limiting (or favoring) entrepreneurial activity. The relationship between inequality and entrepreneurial activity is the fundamental issue that we explore here.

In a perfectly homogeneous world we could not predict who would become an entrepreneur or be self-employed; it would be attributable to chance, since there is no variation in the potential explanatory variables. Identifying who is more likely to be an entrepreneur, and why, thus rests on the existence of heterogeneity within a population, such as inequality in access to financial resources, education, or other valuable possessions. This heterogeneity operates at two levels, individual and collective. At the individual level, having better access to financial resources and more education (for example) appears to foster entrepreneurship in capital- and skill-intensive sectors (Lofstrom et al., 2014). Effects such as these have been already been explored in considerable depth.

By contrast, of interest to us is the possibility that *inequality* per se *also affects the propensity to be an entrepreneur or self-employed.* We examine the possible reasons for this below, but the key idea is that collectively, inequality may change the ability of people to gather together the resources needed to be successful entrepreneurs.

Our overarching view is that there are thresholds to becoming self-employed, and even more so to pulling together the combinations of resources and personal attributes required to become an employer. Greater inequality leaves more people unable to make the transition to self-employment, leaving casual laboring as the occupation of necessity. This same inequality increases the number of employers in a society, by concentrating resources – such as land or finance – enough for significant numbers of people to be able to cross this higher threshold. These entrepreneurs are not simply born, they are created.

Working inductively, we seek to answer the question of whether inequality affects entrepreneurship through the analysis of cross-sectional data from a large-scale survey of the economic conditions of individuals across India. We use a number of dimensions of inequality to explore empirically how inequality interacts with entrepreneurship, operationalized as self-employment or as employing other people. Using data from India makes good sense: only in a very large country can one observe sufficient variations in