

The Price of Entrepreneurship. Evidence from the Lab*

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Abstract

We study a stylized experimental labor market in which “entrepreneurs” (i.e., principals) compete to attract “employees” (i.e., agents) by offering a contract from a fixed menu. Treatment conditions define the technology which selects principals from the subject pool. In the baseline treatment, principals are randomly selected; in the “free entry” treatment, principals volunteer for the role at no cost for them; in the “costly entry” treatment, the identity of the principals is determined by the outcome of a multi-unit first price auction.

We are primarily interested in explaining the individual characteristics of the principals’ pool as a function of the selection technology. In this respect, we find that *unobservable characteristics*, (with specific reference to psychological traits, cognitive abilities and elicited risk and social preferences) are salient in the decision of competing for a principal position, rather than standard socio-demographics.

We are also interested in comparing the downstream labor markets in terms of their efficiency (i.e., their ability to generate effort on behalf of the agents), together with their profitability (for all parties involved, that is, wages and profits) as a function of the selection mechanism. In this respect, we find that, in free, or costly, entry relative to random, principals offer more efficient wages in exploiting strategic complementarities in employees’ effort, which leads to higher payoffs for both.

Keywords: agency, BIG 5, entrepreneur, entry cost, laboratory experiment, profit, psychological traits, risk, social preferences, uncertainty

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