Do Entrepreneurs Pay to Be Entrepreneurs?

Some small-business owners are motivated more by values than financial gain

Richlands Dairy Farm in Blackstone, Va., has been in the Jones family for generations. Entrepreneurs like the Joneses face many challenges in running their own businesses.

By Tim Sablik

The Jones family has been farming in Blackstone, Va., longer than the United States has been a country. From the mid-18th century to the mid-20th century, they grew mostly tobacco. In 1954, "Grandpa" Jones returned to the farm with a degree in agronomy from Virginia Tech and decided to try his hand at dairy farming. His decision proved to be prescient. Milk prices rose steadily over the next several decades, while tobacco lost its luster in the wake of growing health concerns over its use.

Coley Jones Drinkwater, her brother Thomas "T.R." Jones, and her sister-in-law Brittany Willing Jones are the third generation of dairy farmers at Richlands Dairy Farm. But despite the long history of their family's business, their parents never pressured them to follow in their footsteps.

"They wanted a better life for us," says Drinkwater. "It's a good life, but it's a very hard life."

It has become even harder in recent years. Milk prices, which normally move in three-year cycles, have been in a slump for the last three years. Most farmers don't expect a rebound anytime soon. The weather has been unusually dry in Virginia over the last decade, affecting how much corn the Joneses can grow to feed their cows, and requiring them to rely more on feed from outside suppliers. And the Trump administration's recently announced tariffs on steel and aluminum have introduced some uncertainty about the costs of maintaining their aging equipment.

"The most challenging thing about dairy farming is that there are so many variables over which you have no control," says Tracey Jones, Drinkwater's mother. "It makes it hard to plan."

That uncertainty is something dairy farmers have in common with most entrepreneurs. One in five new businesses fail in their first year, and only half survive to their fifth anniversary, according to the Bureau of Labor Statistics. In theory, those greater risks should come with the chance for great rewards. The typical image of an entrepreneur is someone like Henry Ford or Bill Gates — an innovator who starts with an idea and a small company and eventually grows their business into a cornerstone of the economy.

While it's true that most businesses start small, most also stay that way. According to the Census Bureau, nearly 90 percent of firms in America employ fewer than 20 people. Most of these entrepreneurs never experience the windfall profits and success of a Ford or Gates. In fact, owning a business can often seem like a losing proposition. A 2000 study by Barton Hamilton of Washington University in St. Louis found that the median entrepreneur earned 35 percent less over 10 years than they would have if they had been traditionally employed.

Given the risks and costs of running a business, what motivates entrepreneurs to keep going? And what role do they play in the overall economy?

Being the Boss

It's unlikely anyone would choose to be a farmer if they didn't enjoy it. The work is hard and dangerous, and it can be a lonely, all-consuming way of life.

"Forty years ago, you had grange organizations, and everyone went to church on Sundays," says Jones. "Now, all of these organizations are losing members. What used to be the social life of a farmer is disappearing."

"I have friends who live 15 minutes away who I hardly see because I'm always here working," adds Drinkwater.

The monetary rewards for all of this work also don't look too appealing on paper. In a 2017 working paper, John Bailey Jones of the Richmond Fed and Sangeeta Pratap of Hunter College and the Graduate Center, City University of New York, studied entrepreneurial behavior using data from dairy farmers in New York. They found that some farmers earned significantly less than what they might have earned in an alternative occupation. It is possible this gap could be overstated, as some research has

IMAGE: COURTESY OF RICHLANDS DAIRY FARM

found that entrepreneurs underreport their income. On the other hand, the wage gap could be even greater than the data suggest. Many employers provide fringe benefits such as health insurance or retirement contributions that are not formally counted as part of their workers' salaries. Business owners must provide these things for themselves, further reducing their effective take-home pay. Why then undertake all the hardships of farming?

"You get to be your own boss," Drinkwater says.

It's a sentiment echoed by many entrepreneurs. In a 2011 paper, Erik Hurst of the University of Chicago and Benjamin Pugsley of the New York Fed found that over half of small-business owners surveyed in the Panel Study of Entrepreneurial Dynamics said that nonmonetary rewards such as being their own boss or setting their own schedule were key motivations for starting their own businesses.

Accounting for these nonmonetary benefits may explain why some small-business owners are willing to work for less than they could potentially earn as employees at another firm. Drinkwater remembers her family having numerous discussions about selling the farm as they struggled during year after year of low milk prices. It would mean giving up not only doing what they love, but possibly also being together as a family. Drinkwater and her brother would likely have to leave home in search of new work. She remembers her father asking her what she would do if they sold the farm.

"I never had an answer for him," she says. "I would be lost for a while before I found something else. Dairy farming is what I feel called to do."

The relative attractiveness of outside work options can also explain how many risks entrepreneurs are willing to take with their business, according to a 2017 paper by Joonkyu Choi, a recent economics Ph.D. graduate from the University of Maryland. Choi found that entrepreneurs with better outside options were willing to take more risks with the hope that they might strike it big and become the next Bill Gates or Jeff Bezos. If they failed, returning to the traditional labor market was still an attractive option. Entrepreneurs who had fewer outside labor options, or who placed a lot of value on nonmonetary benefits like being their own boss, were more cautious and unwilling to take risks that might jeopardize the future of their businesses.

Growing Pains

Ultimately, the Joneses decided not to sell their farm. But to stay in business, they would need a plan to make money. They first looked at going bigger. Like many modern dairy farms, Richlands uses machines to milk their cows (a setup referred to as a milking parlor). Larger farms with over a thousand cows can run these machines nearly around the clock. With only 250 cows, Richlands cannot take full advantage of their equipment.

"Our milking parlor is built to run about 18 hours a day, but we only run it for eight. So it's not running as efficiently as it could," says Drinkwater.

Quadrupling the size of their herd would require more land than they had available, though. Drinkwater proposed that they instead build a creamery. That would allow them to process and sell dairy products, like milk and ice cream, on site. Currently, all of their milk is sold wholesale to processors before winding up on grocery store shelves. This leaves Richlands at the mercy of price fluctuations in the national milk market. If the price of milk suddenly declines, Richlands may find itself earning less than expected for the milk it produced. By processing and selling milk to consumers themselves, the Joneses will have more power to set prices for their milk products, which in turn gives the farm more certainty over the price it will receive for its raw milk.

"It will be two separate businesses. The creamery will buy milk from the farm at a set price, which gives the farm the ability to budget for the first time ever," says Drinkwater. Richlands already has an eager customer base. The farm began offering tours and hosting agritourist events such as their fall festivals four years ago, and they have averaged hundreds of visitors each weekend. The only stumbling block was securing the more than $1 million needed to finance construction of the creamery.

Obtaining the credit they need to grow and thrive can often be a stumbling block for small businesses young and old. Entrepreneurs starting out may have little to offer lenders in terms of collateral. Additionally, lenders may not understand enough about the business to assess its risk or may simply be unwilling to take a chance on any startup given that a large share of them fail. The New York Fed regularly publishes a Small Business Credit Survey to assess startups' access to financing. According to a report published in 2017, nearly 70 percent of startups that applied for loans said they received less than they asked for. In their study, Jones and Pratap found that borrowing constraints reduced the profitability of dairy farming. Farms that want to undertake a project to boost their productivity may simply be unable to.

"In agriculture, financing is very important," says Eric Paulson, executive secretary and treasurer of the Virginia State Dairymen's Association. "But if you go into a local bank, most won't understand a lot about how a dairy farm operates. Fortunately, we do have a few good lending institutions that have the specialized knowledge to work with farmers." One of those institutions, Farm Credit, provided a loan for Richlands' creamery project.

Policymakers have long had an interest in supporting entrepreneurs by facilitating access to credit and through government programs intended to mitigate some entrepreneurial risk. For example, farm price support programs and crop insurance have attempted to reduce the price variance faced by famers. The rationale for this support is that what's good for entrepreneurs is good for the overall economy.

"New firms contribute disproportionately to job creation," says Ryan Decker of the Federal Reserve Board of Governors. In a 2014 paper with John Haltiwanger of the University of Maryland and Ron Jarmin and Javier

Miranda of the U.S. Census Bureau, he found that the fastest-growing businesses are disproportionately young and small (at least to start) and account for half of overall job growth. "We also see an important role for young businesses in aggregate productivity growth," he says.

But when it comes to driving economic growth, not all entrepreneurs are the same.

Engines of Growth

In their 2011 paper, Hurst and Pugsley showed that while some entrepreneurs desire to grow and innovate, most simply enjoy the nonmonetary benefits of running their own business and being their own boss. They express little desire to expand or innovate significantly.

"Economists who study entrepreneurship often use a distinction between subsistence or lifestyle entrepreneurs and transformational entrepreneurs," says Decker.

It is the smaller, latter group that accounts for the outsized role startups play in employment and productivity growth. Transformational entrepreneurs express more of a desire to grow their business and tend to be risk-takers, even exhibiting a greater propensity to engage in illicit activity when young. Lifestyle entrepreneurs are more likely to run businesses that are similar to many others, such as restaurants, auto repair shops, or law offices.

Some economists have argued that policymakers interested in fostering employment and productivity growth in the economy would be better served investing in transformational entrepreneurs rather than small businesses as a whole. In fact, transformational entrepreneurs may need the help now more than ever. Decker's research with Haltiwanger, Jarmin, and Miranda shows that the entry of high-growth startups has slowed since 2000. The reasons for this are unclear, though one possibility is that growing market concentration across sectors has given incumbents more market power to block or absorb would-be competitors. (See "Are Markets Too Concentrated?" p. 10.)

It would be a challenge to determine up front which new businesses aspire to grow and which do not, however. Economists have identified various differences between lifestyle and transformational entrepreneurs, but many of these characteristics are not easily observable. Ross Levine of the University of California, Berkeley and Yona Rubinstein of the London School of Economics and Political Science suggest one novel way of distinguishing between the two groups for research purposes. In a 2017 article in the *Quarterly Journal of Economics*, they compared owners of incorporated and unincorporated businesses. Incorporated businesses enjoy some protections from legal and financial risk at the cost of fees and increased regulatory requirements. Levine and Rubinstein reasoned that only entrepreneurs interested in growing their business and taking large risks will incur the costs of incorporation.

Some economists, like Hurst and Pugsley, have suggested that broadly promoting small businesses when most do not express a desire to grow or innovate may not substantially increase economic growth and could even have distortionary effects. But to the extent that it is difficult to distinguish between the two types, it may be worthwhile for society to support all entrepreneurs because some of them will have large positive effects on the economy. Decker and his co-authors found that transformational startups play an important role in keeping the economy innovative and nimble in the face of supply and demand shocks.

Societies might also value the role that entrepreneurs play in local communities as leaders or role models. Nonmonetary considerations such as these could motivate support for entrepreneurs broadly, even those who do not go on to innovate or expand their business.

"My dad started a CPA firm that provided for our family for decades," says Decker. "He became an important fixture in the local business community. And while he worked a lot of hours, he still had the flexibility to come to my basketball games. So we might value these kinds of businesses for a lot of reasons, though this may not translate into targeted policy support."

At Richlands Dairy Farm, the agritourism events and creamery expansion that grew out of the Joneses' desire to save their family farm have given them an opportunity to educate visitors who are, in many cases, several generations removed from life on the farm.

"It's always satisfying to see people more comfortable with where their food comes from," Drinkwater says. "We had one woman on a tour who said she had switched to soy milk because she thought that cows in the dairy industry were mistreated. But after our tour, she said she was going to switch back to regular milk. What better compliment could you get than that?" **EF**

Readings

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