KAUFFMAN

The Foundation of Entrepreneurship

KAUFFMAN DISSERTATION EXECUTIVE SUMMARY

Part of the Ewing Marion Kauffman Foundation's Emerging Scholars initiative, the Kauffman Dissertation Fellowship Program recognizes exceptional doctoral students and their universities. The annual program awards up to fifteen Dissertation Fellowship grants of $20,000 each to Ph.D., D.B.A., or other doctoral students at accredited U.S. universities to support dissertations in the area of entrepreneurship.

Since its establishment in 2002, this program has helped to launch world-class scholars into the exciting and emerging field of entrepreneurship research, thus laying a foundation for future scientific advancement. The findings generated by this effort will be translated into knowledge with immediate application for policymakers, educators, service providers, and entrepreneurs as well as high-quality academic research.

Kauffman Dissertation Fellowship Program KDFP Kauffman Dissertation Fellowship Program KDFP

www.kauffman.org/kdfp

Employee Departure from Organizations: Three Essays

Seth Carnahan
University of Maryland

This dissertation studies employee departure at multiple levels of analysis. First, I examine environmental-level processes that pull employees out of their firms and into new organizations, focusing on the release of resources that accompany the failure of rival firms. I next study the implications that employee departure has for former coworkers, examining how the departure of a highly paid woman from the firm affects the compensation of her female colleagues. Finally, I connect employee departure to organizational performance, examining whether stability at one hierarchical level in the organization can compensate for departure at another hierarchical level in the organization.

Category: Strategy, Entrepreneurship, Organization Theory
Keywords: Firm Creation, Employee Turnover, Labor Markets

Employee Departure from Organizations: Three Empirical Essays

Seth Carnahan
University of Maryland

Executive Summary

My dissertation focuses on employee departure from organizations. Employee departure is a significant phenomenon – national surveys by the firm CompData indicate that voluntary turnover rates averaged between 9.8% and 12.5% between 2008 and 2012 in the United States, with higher skilled industries like banking and finance and legal services at the upper end of the distribution. Consequently, departures attract the attention of a wide range of parties. Business managers want to retain their best workers and respond as effectively as possible to the turnover of key employees. Policy makers want to understand how employees moving from one firm to another may influence local economic activity. Individual workers want to know how the prevalence of departures in the US economy will impact their careers. And finally, researchers are interested in explaining the processes that link departures to each of the above outcomes (career success, company performance, and economic growth). Addressing each of these items would be impossible over the course of a career, much less in one document! My dissertation makes progress on the problem by breaking it into pieces across three essays. I provide an outline of the research question, data, and findings for each essay below.

Essay 1: New Firm Creation following Failure of Rival Organizations

Discussions of the connection between firm creation and firm failure usually center on what Austrian economist Joseph Schumpeter famously calls “creative destruction”: the upending of existing firms by new firms who come to the market armed with new ideas. This essay turns this approach on its head and asks whether the dissolution of one firm can cause employees in other firms to quit their jobs and start new organizations.

There are reasons to believe that the failure of one firm might lead to the birth of others. When a firm fails, its resources like employees, customers, and physical assets, do not disappear. In fact, they may be available at better prices than normal as workers find themselves suddenly unemployed and must scramble to find new jobs, and physical assets are sold quickly to satisfy debt holders. These discounts may provide opportunities for entrepreneurs working in other organizations to use these resources and start new firms.

A good anecdotal example of this type of activity comes from the dissolution of WebVan, an online home-delivery grocer which formed and failed in San Francisco during the dot-com era. The Bay Area today is dotted with WebVan's distinctly colored vehicles, which are delivering all sorts of goods other than groceries by entrepreneurs who bought the vans on the cheap during WebVan's liquidation. Another example comes from the closure of NASA facilities following a reduction of funding by Congress and the Obama administration. NASA's engineers did not vanish into thin air; rather they became some of the first employees of new startups in Silicon Valley and elsewhere, easing the creation of new firms by providing a source of highly skilled human capital for entrepreneurs.

As a researcher, it is difficult to isolate in large datasets the types of effects highlighted in these anecdotes. This is because companies fail for all kinds of reasons, and many times the reason that one firm fails will be the same reason that potential entrepreneurs choose not to start a new organization in the same industry. For example, the failure of Lehman Brothers may have made some lower-priced investment bankers available, but the collapse of the housing market that precipitated Lehman's decline probably also persuaded potential entrepreneurs that 2008 was not the right time to start a new investment banking firm. To return to the example of WebVan, the burst of the dotcom bubble killed the company and probably also indicated that this was not the right time to start an online grocery delivery business. Instead, the vans moved to other parts of the economy.

To overcome these problems, a researcher either needs fine-grained information about firm failures and firm startups for multiple industries (in order to pick up shifts of resources to other sectors of the economy like in the WebVan example or the NASA example) or the researcher needs some kind of shock that kills one firm while not affecting the startup decisions of potential entrepreneurs working for other firms in the industry. I use the second approach. I examine law firm failures that are precipitated by the unexpected death of a partner attorney, and I see whether those dissolutions cause attorneys working for other law firms to start their own organizations.

My analyses reveal that when a law firm dissolves following the unexpected death of one of its partners, attorneys working for other firms are three times more likely than average to start a new firm.[1] Furthermore, higher earning attorneys are more likely to strike out on their own following the failure of a rival, indicating that the ability to attract the clients released by the rival's failure may be important in translating failures into startups in this industry. In addition, attorneys that work for firms with less opportunity for advancement are also more likely to start their own firms, suggesting that rival failures may provide openings for employees who feel undercompensated in their current organizations.

This essay has several managerial and policy implications. For business managers, it provides the insight that the satisfaction of high quality employees should be monitored closely following the failure of rival companies. Otherwise, these workers may use the opportunity to

[1] The average attorney in my data (which is US Census data covering all attorneys working in 10 large US states) has a one percent likelihood of starting her own firm in any given period. When a rival firm fails, this likelihood rises to three percent, which is a three-fold increase.

leave the organization and start a new competitor that replaces the one that recently dissolved. For policy makers, it highlights a silver lining that may accompany the failure of a local organization – entrepreneurs working for other firms may be interested in using that firm's resources to start something new. As a consequence, it may be important to reduce impediments to entrepreneurship like non-compete clauses to insure a robust regeneration of activity following one firm's failure. Additionally, it might be important to keep legal impediments to bankruptcy low. If failed ideas are scrapped more quickly and allowed to fertilize the creation of new businesses, it may foster local growth. However, further research is needed to tell whether resources (e.g. employees, equipment, buildings) become more productive when they move from a struggling firm into a new organization.

Essay 2: Does the Exit of a Highly Paid Woman from the Firm Increase or Decrease Her Female Colleagues' Earnings? Evidence from Unexpected Deaths in Legal Services

When Marissa Mayer left her post as a Google vice president to become the President and CEO of Yahoo!, many hailed her ascent as a triumph for women in the male-dominated field of information technology. This is consistent most academic and popular accounts of employees moving from one firm to another: the mobile person is celebrated. Less closely examined, however, are the individuals that remain behind at the prior firm. This may be especially salient for members of underrepresented groups when one of their members departs the firm. For example, how did the departure of Marissa Mayer affect the women working at Google? My second essay addresses a close variant of this question using data on the legal services industry.

Valid arguments exist on both sides of the question. On the one hand, to the extent that women are likely to mentor other women and advocate for each other in performance reviews and other situations, the departure of Meyer might be negative for the careers of the women at

Google. Mayer was the 20th employee and first female engineer hired by Google, so she was likely an influential voice within the firm. On the other hand, her departure might clear the way for other women to ascend. For example, if she mentored other female executives, one of them might be well-positioned to take her place. Taking a dimmer view, Google might promote another woman following Mayer's departure in order to maintain a female "quota" at the top of the firm and conform to gender diversity expectations of customers, employees, and other stakeholders.

My second essay uses US Census data covering all attorneys working in the legal services industry in 10 large US states to provide an initial answer to this puzzle.[2] I examine how the departure of a highly paid female attorney affects the earnings of her female colleagues. It is difficult to see the departure of a woman from a law firm, observe the change in her female colleague's earnings, and then argue that any shift in earnings was caused by the colleague's departure. There could easily be an unmeasured third factor (a shift in the firm's gender policies, for example) that would drive both the departure of a female attorney as well as the earnings of her former colleagues. To overcome this problem, I use the unexpected death of highly paid attorneys as a quasi-random stand-in for departure. This way, I can see how colleagues' earnings are affected by a woman's exit, without worrying about the measurement problems stemming from the reason she left the firm.

The results are striking. Following a highly paid colleague's death (of either gender), the average earnings of other members of the firm increase about 3%. This increase may occur because surviving members of the firm inherit the client work that was formerly completed by

---

[2] These are the same data as used in the first essay. They provide the total taxable earnings of all employees of the legal services industry in the ten states (including California, Florida, Illinois, and Texas), as well as employee gender, age, and date of death, among other information.

the deceased attorney. The deeper insight comes when we examine how the gender of the deceased and the gender of the surviving attorney affect this result.

Men experience a relatively small increase in earnings when a colleague passes away, and this increase is not dependent on whether the deceased person is male or female. Women, on the other hand, experience a large (8%) increase in earnings after a female colleague passes away; this increase is significantly larger than what women experience when the deceased colleague is male (about 2%).   This suggests that women are somehow uniquely positioned to benefit when one of their female colleagues exits the firm.

In order to better understand the reasons behind this pattern, I examine the effect of other variables. I find that the result is stronger when the surviving female attorney is highly paid, older then her deceased female colleague, or higher in the firm's earning distribution than her deceased female colleague. Although I cannot measure client relationships, this pattern of results suggests that clients of the deceased woman may move their work to her female colleagues, either because the clients prefer female attorneys or because the women were sharing clients prior to one woman's death. This larger book of business may provide the surviving colleague with higher earnings. Another interpretation suggests that the earnings increase is driven by bargaining power—other highly paid women whose visibility makes them important for the firm's gender legitimacy may be able to bid up their earnings due to the sudden scarcity of women in the organization.

The primary contribution of this essay is to point out a paradox related to the bargaining power of underrepresented groups. While it makes sense to think that a group's overall bargaining power will increase as a function of the group's size in a particular company, I find that an *individual's* bargaining power increases as her overall group shrinks in size. This is consistent with the notion that employees have increased bargaining power when their skills are scarce, and expands the idea to include demographic characteristics which may have external legitimacy as well as functional considerations. For employees interested in career strategy, this idea highlights that scarcity is a source of bargaining power. Opportunities are created when coworkers exit the firm, and employees may want to bear in mind all of their contributions to the organization (i.e. provision of skills as well as provision of external legitimacy) when positioning themselves to benefit.

Essay 3: Turnover, Managerial Tenure, and Organizational Performance: Evidence from Injuries in the National Football League

While my first two essays focus primarily on individual outcomes, my third essay views employee departures through the lens of the company that loses valuable workers. An enduring question for business managers and researchers is how employee departures affect company performance. It makes sense that a small number of departures may help refresh the organization, especially if those workers were not the best match for the firm. However, most researchers and practitioners seem to agree that the departure of key employees is generally not good for the firm, especially in the short term.

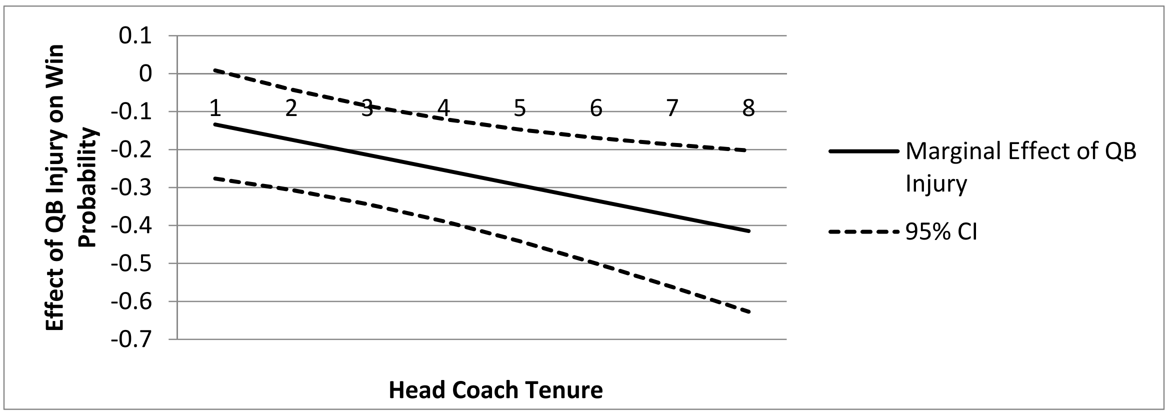
My view of the problem is very similar to that of my second essay: we are too focused on the person that leaves, and not paying enough attention to the people that remain with the organization after a departure. In particular, we seem to forget that managers are the people most responsible for responding to the challenges posed by the exit of their subordinates. In my third essay, I examine whether stability at the managerial level of the organization increases or decreases the negative effect of turnover at the employee level.

One can see arguments for why managers who have been with the organization a longer time, and thus are a source of organizational stability, may be better or worse than shorter tenured managers when responding to the departure of a key subordinate. Managers who have been with the organization for a long time likely know the innermost details of the firm, including the skills and abilities of the remaining employees, so they may be well positioned to re-allocate tasks and to pick the best replacement for the departed worker. On the other hand, managers who have spent long periods of time with the organization may be unaccustomed to dealing with change. The departure of an important subordinate is certainly a disruptive event and it may place pressure on the routines and processes that the manager has developed during his time with the firm.

In general, it is challenging to measure the effect that employee departures have on the performance of their former companies. If we see an employee leave the firm, and then the performance of the firm declines, it is hard to know whether the employee left precisely because she could see the decline on the horizon. My third essay overcomes this problem using data from the 2010 and 2011 seasons of National Football League to examine how teams respond to the loss of their most important player—their quarterback—due to the chance event of injury.

Sports are a useful, and increasingly common, laboratory for researchers to study organizational behavior. The problems of coordination, motivation, and strategy are common in both sports and traditional business organizations, and sports provide researchers with variety of indicators of performance of both firms and their employees. While injuries are not a perfect substitute for normal employee turnover because the player eventually returns to the team, they are a useful window into studying how organizations respond to the loss of a member of the group because we do not have to worry as much about the reasons *why* the employee decided to depart.

I cast the head coach of each NFL team as the organization's top manager, and I examine whether teams with longer-tenured coaches perform better or worse following quarterback injury. As shown in Figure 1, my results support the second argument – teams with longer tenured coaches perform w*orse* following injury to the team's quarterback. For example, when a coach's tenure with the team doubles from four years to eight years, an injury to his quarterback reduces his team's chances of winning by 40% as compared to 25%.



This novelty of this essay comes from emphasizing to researchers an idea that is already well-known to practitioners – a manager often has the most responsibility for dealing with the departure of a subordinate. While it perhaps seems natural to think that long-tenured managers are well-prepared to deal with the departure of subordinates, my results suggest that it may be important to consider the inertial consequences of the manager's time with the firm. More broadly, thinking carefully about the interaction between stability and turnover at different levels of the organization may help extend our frameworks for thinking about how organizations can best respond to the departure of key employees. After all, Chester Barnard, one of the foremost practitioner-theorists in the annals of organization studies, long ago made the observation that one of the key executive functions is to "replace the losses that continually take place by reason of death, resignation, 'backsliding,' emigration, discharge, excommunication, ostracism."

Conclusion

Across three essays, my dissertation views employee departures through the lenses of entrepreneurship, gender in organizations, and firm performance. In each essay, I identify an important question related to one of these topics, and I shed light on its resolution by building multi-disciplinary theory and testing the arguments with careful research design. The results have important implications for individual careers, firm strategy and performance, and economic growth.