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Employee Mobility, Employee Entrepreneurship, and Employee Value Capture: Labor Market Frictions and the Impact of Social Comparison Costs on Compensation

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Abstract

Much of the discussion in the strategic human capital literature focuses on how firms can exploit isolating mechanisms that limit the mobility of employees. This dissertation studies two important facets of strategic human capital research related to the mobility of employees. The first essay explores how a labor market frictions lens can connect the strategic human capital literature and the employee entrepreneurship literature, two complementary but largely disparate literatures. The second essay explores how multi-location firms, because of social comparison processes within the firm, may facilitate the spread of compensation increases across geographic markets.

Executive Summary

Strategic human capital research examines how firms use their valuable human capital to gain and maintain a sustainable competitive advantage. This literature has its roots in the resource-based view of the firm, which suggests that resources that are rare, difficult to imitate, nonsubstitutable, and valuable can be a source of competitive advantage. To the extent human capital fits these criteria, it can be a source of competitive advantage for the firm. But, this literature also recognizes that human capital is unique as a firm resource—human capital is contained in people with agency who can demand pay increases and quit their jobs if their demands are not met. The ability of employees to leave firms makes it difficult for firms to create and sustain a human capital-based competitive advantage.

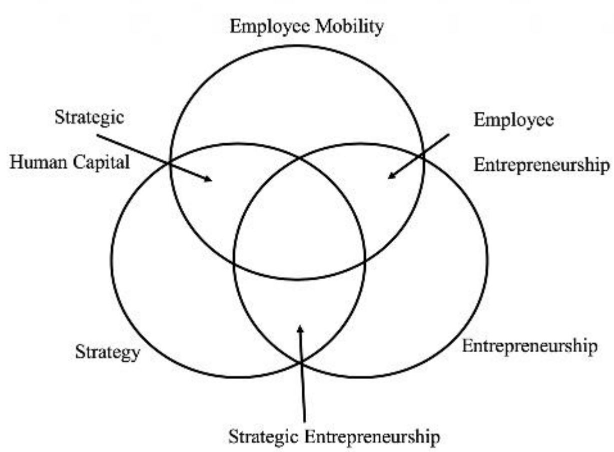
Bridging Strategic Human Capital and Employee Entrepreneurship Research: A Labor Market Frictions Approach

Because the threat of employees leaving a firm can undermine a human capital-based competitive advantage, the strategic human capital literature generally views employee mobility as a negative consequence for firms. Therefore, a primary focus of the strategic human capital literature is identifying those factors that allow a firm to constrain employee mobility without having to allow employees to capture all of the value they create. With mobility constraints in place, firms are able to retain human capital for less than its use value and realize a competitive advantage. The strategic human capital literature, therefore, draws deeply on labor market frictions as a potential source of mobility constraints.

On the other hand, a relatively new but growing stream of literature has examined the causes and consequences of employee mobility from existing firms to entrepreneurship. This literature also relies on labor market friction logic. In this literature, however, mobility to entrepreneurship is not viewed negatively. Instead, this literature recognizes, and celebrates, that labor market frictions that constrain mobility of employees to existing firms may increase the likelihood of mobility to entrepreneurship.

So, strategic human capital literature draws deeply on labor market friction logic as does literature on employee entrepreneurship. However, these literatures leverage labor market friction logic in distinctly different ways, from distinctly different perspectives, and with distinctly different objectives. Figure 1 depicts the relationships among these literatures. Strategic human capital scholarship exists at the intersection of the strategy and employee mobility literatures, while employee entrepreneurship scholarship exists at the intersection of the entrepreneurship and employee mobility literatures. That these literatures both draw on the market friction logic embedded in the employee mobility literature, but focus on different objectives and outcomes of interest, provides an opportunity to link the two theoretical conversations through the language and logic of labor market frictions and, in so doing, to explore the intersection between strategic human capital and employee entrepreneurship research.

Figure 1: Visualizing Intersections in Extant Literature



Labor Market Frictions. Market frictions are imperfections in product or factor markets that inhibit perfect competition. Economic theory suggests that in perfectly competitive markets, economic rents are unattainable. By preventing perfectly competitive market outcomes, market frictions can facilitate rent creation and rent capture by market participants. In both the strategic human capital and employee entrepreneurship literatures, understanding how market frictions in labor markets impact the mobility of employees into and out of firms is a key concern.

A common theme across strategic human capital theory is that labor market frictions that constrain voluntary employee mobility are necessary for firms to capture value from employees. Valuable human can be very difficult to obtain or imitate and yet may be particularly important for achieving a competitive advantage. Unlike other strategic resources and capabilities that the firm can build, borrow, and/or buy in the market, human capital is embedded in individuals with agency. These individuals can choose to leave their employers for any number of reasons and for any number of alternative destinations, and when they do, they take their valuable human capital and relationships with them. This threat of voluntary employee mobility, which is not present in other strategic factor markets, is one source of the managerial dilemmas that firms face when dealing with this unique firm resource.

Similarly, employee entrepreneurship research explores how labor market frictions impact the decisions of employees to leave employment to start a new venture. The employee entrepreneurship literature generally views entrepreneurship as a career choice: potential entrepreneurs consider their opportunities and their opportunity costs and then choose to become an entrepreneur and stay an entrepreneur if that is what the entrepreneur wants. Labor market frictions, therefore, that limit the utility of employees at their current employer, or constrain the ability of employees to be successful in founding a new firm, fundamentally shape the career choices of potential employee entrepreneurs.

Table 1 contains a description of common labor market frictions and their impact on employee mobility and employee entrepreneurship, based on a review of the strategic human capital and entrepreneurship research. Each row describes a friction, provides a high-level summary of the effect of that particular outcome on employee mobility and employee entrepreneurship, and then identifies the extent to which the outcomes in the different literatures appear aligned.

Table 1: Common Labor Market Frictions and Their Impact on Employee Mobility and Employee Entrepreneurship

Labor Market Friction	**Description**	**Impact on**		**Alignment?**
		Employee Mobility	**Employee Entrepreneurship**	
Firm Specificity and Complementary Assets	Demand-side friction arising when the worker invests in knowledge, skills and abilities that are uniquely valuable in the context of the firm's idiosyncratic resource and capability bundles.	***Negative***	***Positive***	Divergent
Social Complexity	Demand-side friction caused when employee value stems from shared routines among socially complex teams.	***Negative***	***Positive***	Divergent
Information Asymmetry/Causal Ambiguity	Demand-side friction arising when it is difficult for outside observers to observe and discern the quality of employees, leading to causal ambiguity and a lemons problem.	***Negative***	***Positive***	Divergent
Thin Markets/Collusion	Demand-side frictions because there are a limited number of alternative employers in a market.	***Negative***	***Positive***	Divergent
Intellectual Property and Non-competes	Demand- and supply-side frictions based on legal protections of a firm's knowledge and intellectual property.	***Negative***	***Negative***	Aligned
Future Opportunities with Employer	Supply-side friction arising from credible future opportunities available at employer.	***Negative***	***Negative***	Aligned
Mobility Costs	Supply-side friction reflecting the costs to an employee of employee mobility and employee entrepreneurship.	***Negative***	***Ambiguous***	Possibly Divergent
Heterogeneous Employee Ability	Demand-side friction arising from thinner markets for low- and high-ability employees.	***Ambiguous***	***Positive***	Possibly Divergent

Why Might These Literatures Diverge?

Scholars in the strategic human capital domain are generally interested in exploring the conditions under which firms are able to capture rents from human capital and gain a competitive advantage over their competitors. Thus, while many strategic human capital studies leverage individual-level data and invoke individual-level theories, their primary research motivation is to explain firm-level differences across established firms. This focus on established firms as the actors of interest may engender an implicit bias towards theoretical and empirical studies that examine mobility to established firms. This perspective treats employee mobility as a negative outcome that should be constrained and leads scholars to systematically ignore the implications of entrepreneurship as an employment outcome. In contrast, the employee entrepreneurship literature explores employees' decisions to found their own firms and is implicitly built on the assumption that entrepreneurship is a career choice. Thus, individuals are the actors of interest in this research and employee mobility is seen a positive outcome that enhances the utility of individuals, facilitates new venture performance, and drives knowledge flows and innovation.

The review of these two literatures suggests an important boundary condition on research in the strategic human capital tradition. Specifically, theories of how labor market frictions restrict mobility and enhance human capital-based competitive advantages may need to be limited to contexts in which entrepreneurship is not an attractive option for employees who are the source of a human capital-based advantage. If entrepreneurship is a viable and potentially attractive options for firms' employees, then strategic human capital theories need to address how entrepreneurship as a mobility destination alters assumptions about the relationship between labor market frictions, mobility, and human capital rents.

Moving Towards Convergence

Human Capital Rents and Employee Entrepreneurship. The strategic human capital literature generally does not address employee entrepreneurship as a pathway for employees to navigate around labor market frictions that might otherwise limit their mobility. Even if employees cannot threaten mobility to an existing firm in order to bargain for higher wages, they can threaten to start a new firm. In some cases, the stronger the labor market frictions that reduce firm-to-firm mobility, the greater the attractiveness of entrepreneurship as a career choice. Thus, a potential consequence of leveraging labor market frictions in pursuit of human capital rents is that firms may inadvertently increase the incentives for their employees to become entrepreneurs, particularly if the affected employees are already inclined towards the rewards available through entrepreneurship. The divergent effects associated with some labor market frictions in preventing employee mobility to established firms versus preventing employee entrepreneurship, therefore, presents an upper bound on how aggressively firms can leverage labor market frictions to appropriate value from their employees.

It remains an open question whether the potential loss of employee entrepreneurs outweighs the benefits of leveraging labor market frictions to retain non-entrepreneurially-inclined employees. If these frictions allow the firm to hold on to non-entrepreneurially-inclined employees at a discount but actually encourage entrepreneurially-inclined employees to start their own firms, what does that mean for the overall human capital-based competitive advantage for the firm? While the mobility outcomes may diverge, it is not as clear, ex ante, whether the implications for competitive advantage also diverge. There seems a fruitful path for future research exploring entrepreneurial mobility and the human capital rents of established firms simultaneously to help us more fully understand when and how these literatures align and diverge.

Connecting Employee Entrepreneurship to Firms' Human Capital Approaches.

In a world where employee entrepreneurship is a threat to firms' ability to capture human capital rents, firms may have to adapt new human capital management approaches to constrain the mobility of entrepreneurially-inclined employees. If firms' use of labor market frictions to constrain mobility to established firms may enhance the threat of employee entrepreneurship, the next step in the logic is to ask how can firms counteract the ability and willingness of entrepreneurially-inclined employees to leave to form a new venture? The strategic human capital lens highlights that firms could respond to entrepreneurship threats by leveraging supply-side frictions that decrease an employee's willingness to leave and become an entrepreneur. For example, firms may offer spin-off or intrapreneurship opportunities to employees whose mobility options with existing firms are limited, but who might otherwise become employee entrepreneurs. These opportunities create supply-side constraints, incenting employees to remain with the existing employer rather than create new competitor firms. In the sections that follow we briefly discuss several potential ways through which firms can reduce the entrepreneurship threats of employees, though there may be many more to explore in future research.

Spin-off firms. In a spin-off, a parent firm creates a new venture in which they maintain substantial equity. Thus, the parent firm gives an entrepreneurially-inclined employee the greenlight to pursue an entrepreneurial opportunity, and further, makes an initial investment in exchange for equity in the new venture. From the parent firm's perspective, they do not completely lose the valuable employee because they retain some of the financial benefits from the human capital of the founder. Additionally, they can "harvest" innovations from these ventures and learn about new technologies. Firms benefit because they did not lose these employees to a competing venture or to a rival; the founders benefit because they reap the financial rewards, meaning and purpose, autonomy, flexibility, responsibility, and human capital development that can accompany entrepreneurship.

Intrapreneurship. Firms can also offer intrapreneurship opportunities to entrepreneurially-inclined employees. In intrapreneurship, employees are given autonomy over and rewards from an innovative activity within the boundaries of the firm. Intrapreneurs typically work closely with other units of the firm and have access to the complementary assets of the parent.

Again, the employer benefits by stimulating innovation and then owning the rights to those innovations. Employees with entrepreneurial inclinations benefit because they receive at least some of the benefits associated with being an entrepreneur.

Through both spin-offs and intrapreneurship, firms leverage supply-side frictions to counteract the adverse effects that demand-side frictions impose on entrepreneurially-inclined employees. By receiving many of the benefits associated with entrepreneurship while remaining associated with their current employer, entrepreneurially-inclined employees are less likely to seek out external entrepreneurial opportunities. While these are just two examples of how understanding the antecedents and consequences of employee entrepreneurship can shape firms' approaches to capturing human capital rents, there are rich avenues of future research exploring how firms can seek to neutralize the dilemmas associated with managing human capital that is free to leave and start a new venture.

Labor Market Frictions and Employer-Employee Matches.

Much of the existing strategic human capital literature implicitly assumes that individuals are randomly assigned to firms. However, employers do not randomly hire employees, and employees do not randomly select employers. Employees may even pick employers based on the intensity of the labor market frictions they anticipate experiencing at the firm. For example, an employee that is not entrepreneurially inclined may be less willing to join a firm where there are fewer options with other firms than an employee who wants to be an entrepreneur and does not care about other outside options. The entrepreneurially-inclined employee always possesses a credible exit threat—starting a firm. As such, the labor market frictions might shape the composition of the firm's workforce. This highlights a path through which strategic human capital researchers can more deeply examine how frictions shape the process by which employees select into firms and how employees are motivated within firms.

Bridging these literatures can provide a foundation for developing richer answers to a variety of research questions regarding the antecedents and consequences of human capital value capture when employee entrepreneurship is a threat. By linking these literatures through their shared focus on market frictions, researchers can contribute to the understanding of how entrepreneurial mobility has firm-level consequences, how firms' quests for human capital rents can enable or constrain employee entrepreneurship, and how managers and policy makers can shape the interaction of individuals and firms.

The Effect of Social Comparison on Compensation in Multi-Location Firms

I then beyond labor market frictions and their focus on mobility constraints (whether to existing firms or to entrepreneurial firms) to explore how social processes that are internal to the firm, regardless of mobility constraints, impact the ability of employees to appropriate value by receiving increased compensation. Traditional explanations of the spread of wage increases across local labor markets focus on labor market competition and mobility as explanations: As compensation increases in a given location, the threat of losing employees to that location causes firms located elsewhere to also increase compensation in order to retain their employees.

While this mechanism may certainly lead to compensation increases, other social processes that do not rely on mobility may also play a part. Specifically, multi-location firms must manage employees across locations and so must worry about more than just local labor market pressures. When facing local labor market pressures to raise compensation, they must consider how their employees located in other markets will react if some of the firm's employees receive compensation increases and others do not. Although office boundaries may lessen the possibility of social comparison, prior research shows that employees within firms, even if not co-located, may compare themselves to each other. These comparisons may give rise to social comparison costs. In order to avoid potential social comparison costs, the firm may be compelled to raise wages for employees in locations that are not experiencing salary increases. If multi-location firms raise compensation for employees in their other locations, this will likely, in turn, put pressure on their local labor market competitors to also increase compensation for their employees. As a novel mechanism for the spread of compensation increases, I propose, therefore, that local labor market competition may interact with social comparison processes internal to multi-location firms and result in the spillover of compensation increases across otherwise distinct labor markets.

Therefore, this essay develops a more complete theory of employee value appropriation by emphasizing the impact of social processes within multi-location firms on compensation across the firms' establishments. In responding to local labor market forces, managers must balance labor market competition in one location with the risk of social comparison costs from employees in other locations. Doing so may lead them to raise wages for employees in locations where the local labor market conditions would not otherwise demand it. This discussion underscores the uniqueness of the labor market among resource markets for firms. Because of the potential inimitability and unique value of human capital, prior strategic human capital research has identified a firm's employees as a potential source of sustainable competitive advantage. In particular, prior literature suggests that in situations where the mobility of employees is constrained, they firm may be able to enjoy economic rents. Nevertheless, this study suggests that social processes within firms, and within multi-location firms in particular, may enable employees to appropriate value above that otherwise available to them on the local labor market even in the face of mobility constraints.

Prior research has suggested that management can respond to potential social comparison costs primarily in three ways: compressing wages, designing the process of the firm to limit social comparisons, and altering the boundaries of the firm to limit social comparisons. This study assumes that when faced with local labor market competition, in the short run multi-location firms will choose to compress wages of employees in order to limit social comparison costs rather than recraft the firm's social architecture or restructure the boundaries of the firm. In this study, I develop a series of testable propositions that theorize about the factors that may impact the likelihood that multi-location firms will have to raise wages, and the amount of the wage increases, for employees in other locations. I suggest that the more employees in one office identify with employees in another office (because they are demographically similar to, geographically proximate to, have a high level of interaction with, or are privy to information about employees in the other office), the more likely it is that firms will have to raise wages for employees in that office if employees in another office of the firm receive market-based wage increases. Similarly, I discuss the factors, such as comparisons with employees of other firms in the local area, that are likely to impact the amount by which firms will need to raise wages for employees in an office for them to feel that they are being treated fairly.

This study has implications for income inequality. Prior research has explored the implications of social comparisons and social comparison costs, particularly in large firms, on overall income inequality in States in the United States. Their analysis suggests that large firms are more likely to compress wages, which leads to lower levels of income inequality in States with a larger proportion of large firms. Similarly, this study has implications for levels of income inequality both within firms and within markets. It seems reasonable that higher skilled workers in one establishment of the firm will be more likely to see comparable workers in other establishments as salient referents. Additionally, they will be more likely to interact with those others, more likely to have information about those others, and more likely to work on interdependent tasks with those others. If these assumptions are true, then there is a greater risk that high skilled workers will impose social comparison costs on the firm if it raises compensation for comparable employees in other locations but not them, and therefore more likely that they will receive corresponding compensation increases. Even if the low skilled workers receive compensation increases, high skilled workers are likely to be able to impose greater social comparison costs on the firm, which suggests that they are likely to receive greater even compensation increases than the low skilled workers. These processes suggest that compensation spillovers from changes in market conditions in another establishment are likely to benefit high skilled workers more than low skilled workers and lead to increased income inequality within the firm. As labor market competitors of firms in these other locations face competitive pressure to also increase wages, the pressure will likely be greatest for their own comparable high-skilled workers. If so, this would result in increased income inequality in the broader labor market as well.

This study reinforces the importance of examining how social processes between employees within firms interact with labor market competition external to firms to produce outcomes we observe in the real world. This study attempts to bring together different perspectives of human nature. On the one hand, I assume that people are emotional and react to perceived inequities. On the other hand, I assume that decisions makers within firms will act in rational ways to reduce the overall costs to the firm. The conjunction of these two seems appropriate when examining organizations from both the individual- and firm-level perspectives simultaneously. It seems realistic to assume that both emotional and rational processes intersect and interact for employees working within organizations.

Prior research on strategic human capital has focused on isolating mechanisms that constrain employee mobility, restricting the ability of employees to bid up their compensation and limiting the extent to which they can appropriate value. This study, however, suggests that for multi-location firms with establishments in different locations, social comparison processes within firms that lead employees to impose social comparison costs on the firm provide a mechanism for employees to receive increased wages. If local labor market forces pressure these firms to raise compensation in one location, employees who feel envious may successfully demand increased compensation in other locations, even if the local market conditions do not require the increases. This theoretical mechanism operates regardless of the presence or lack of mobility constraints and suggests the importance of exploring the intersection and interaction of social processes between employees within firms and labor market forces external to firms when attempting to understand the ability of employees to appropriate value from firms through their compensation.