

Human Capital and Entrepreneurship: the Jack of All Trades Hypothesis

Created by: Nádia Simões

Version received: 14 November 2019



We discuss the seminal contribution proposed by Lazear (2004, 2005) – the jack of all trades hypothesis. The basic idea of this approach is that a balanced set of (managerial) skills promotes entrepreneurship entry. When the skills are unbalanced, the individual will opt to become specialist.

The economic importance of entrepreneurship is widely recognized. Therefore, it is not surprising the vast amount of research devoted to the study of the determinant factors of entry and success. A critical factor is the influence of human capital. A disruptive contribution in this area was advanced by Lazear^{[1][2]}. After this pioneering study, several other studies were produced aiming to develop theoretical extensions of the original model or to conduct empirical tests of the hypotheses putted forward by Lazear.

In very simple terms, the basic idea is that a balanced set of (managerial) skills is a key condition for entrepreneurship. Let us discuss the central elements of the model.

The basic question addressed by this model is “who becomes an entrepreneur?” In order to answer this question, the model compares the income that the individual can obtain as specialist and as entrepreneur.

The main hypotheses of the model are as follows: (i) entrepreneurs “must be good in many things” (Lazear^[2], p. 652); (ii) there are two relevant skills – skills 1 and 2; (iii) the entry into entrepreneurship is made through new venture creation; (iv) the decision between become employee or entrepreneur occurs in one single moment in time.

Taking these hypotheses into account, how can we answer the fundamental question of the model?

Let $x_1, x_2 \geq 0$ be the level of skills 1 and 2 of the individual. As mentioned above, the individual needs to compare the income obtained as specialist and as entrepreneur. If he/she works as a specialist, the level of income obtained depends on his/her best skill – $\max [x_1, x_2]$ – while if he/she opts to be an entrepreneur his/her income depends on his/her weakest skill – $\lambda \min [x_1, x_2]$, in which λ is a parameter that captures the value, obtained by market equilibrium, of entrepreneurial talent. Therefore, the individual will opt to become entrepreneur when:

$$\lambda \min [x_1, x_2] > \max [x_1, x_2] \quad [1]$$

Equation [1] makes clear that the critical choice between entrepreneurship or specialization depends on λ , x_1 , and x_2 . The value of λ ($\lambda \geq 1$) determines the supply of entrepreneurs as follows. When $\lambda = 1$, no one chooses to become entrepreneur because $\min [x_1, x_2] > \max [x_1, x_2]$ is an impossible condition. As λ increases, the supply of entrepreneurs rises since the market value of entrepreneurial talent increases. For $\lambda > 1$ (the general case), five distinct cases must be considered.

The first case corresponds to the points where $x_1 = x_2$. When this occurs, $\min [x_1, x_2] = \max [x_1, x_2]$. This corresponds to a perfect balance between and and the optimal choice is to become entrepreneur.

In the remaining four cases, $x_1 \neq x_2$. When $x_1 > x_2$, the choice is between to become entrepreneur or to be a specialist with income x_1 (the best skill). The individual will choose to become entrepreneur when $\lambda x_2 > x_1 \Leftrightarrow x_2 > \frac{x_1}{\lambda}$. On its turn, when $x_2 \leq \frac{x_1}{\lambda}$ the individual opts to specialize, making use of his/her best skill.

The same kind of considerations is valid when $x_1 < x_2$. In this case, the individual will opt to become entrepreneur when $x_2 < \lambda x_1$. In the opposite case, the best choice is to specialize (in his/her best skill, x_2).

A direct implication of the model discussed above is that the choice to become entrepreneur requires a balanced set of skills. The rationale for being entrepreneurs – “they must be relatively good (or relatively bad) at everything” (Lazear^[2], p. 656) – is known as the jack-of-all-trades (JAT) proposition and corresponds to the true core of Lazear’s contribution.

References

1. Edward P LaZear; Balanced Skills and Entrepreneurship. *American Economic Review* **2004**, *94*, 208-211, 10.1257/0002828041301425.
2. Edward P. LaZear; Entrepreneurship. *Journal of Labor Economics* **2005**, *23*, 649-680, 10.1086/491605.

Keywords

entrepreneurship; skills; balance; human capital



© 2019 by the author(s). Distribute under a Creative Commons CC BY license