

## SELF EMPLOYMENT AS A STEP IN THE RETIREMENT PROCESS

Michael D. Giandrea\*, Kevin E. Cahill, and Joseph F. Quinn

### INTRODUCTION

Older Americans are staying in the labor force longer than prior trends would have predicted and they often change jobs late in life.<sup>1</sup> In fact, the majority of older Americans who have had career jobs make a job transition prior to complete retirement.<sup>2</sup> These transitions are often within wage-and-salary employment, but can also be from wage-and-salary work to self employment. Self employment can be an attractive option for many older workers because it provides opportunities not found in traditional wage-and-salary jobs. Indeed, national statistics show that self employment becomes more prevalent as workers age.<sup>3</sup> This Issue Brief examines the prevalence and determinants of a specific type of self-employment transition – those that serve as a step in the retirement process.

Self-employment transitions prior to retirement are of particular importance to employers and policymakers. The oldest Baby Boomers are now approaching traditional retirement age, and their movement out of the labor force will strain existing sources of retirement income. Today, the ratio of workers to Social Security recipients is about three to one; by 2030, the ratio will be two to one.<sup>4</sup> As fewer workers support a growing retiree population, policymakers may look for ways to encourage older workers to delay departure from the labor force.

Self employment is one option because it offers real advantages that are valued by older workers, such as independence and flexible work hours.<sup>5</sup> Older workers may also have access to capital that makes self employment possible, and they have a lifetime of experience to bring to a business venture.

Employers may also benefit from these late-in-life transitions, as older workers become an increasingly attractive option to fill an expected shortfall in skilled workers.<sup>6</sup> Older wage-and-salary workers who switch to self employment may do so because of what is lacking in wage-and-salary employment rather than what can be gained in self employment. Employers may be able to woo those workers back, or prevent the transitions to begin with, by offering older workers the flexibility of work schedule that many seek.

The country as a whole benefits if self employment keeps individuals in the labor force longer. These workers remain productive, have higher incomes, and are likely to be less dependent on public programs, while the country has more goods and services to distribute among an aging population.

In this Issue Brief, we examine transitions into and out of self employment among older workers, and analyze some of the demographic and economic determinants of these transitions.<sup>7</sup>

In this Issue Brief, we examine transitions into and out of self employment among older workers, and analyze some of the demographic and economic determinants of these transitions by answering:

- How is retirement different now than in the past and what does that mean for employers?
- Why is it in employers' interests to retain their older workers and how do they do this?
- Why are older workers more likely than younger workers to transition from wage-and-salary positions to self employment?

## SELF EMPLOYMENT TRENDS:

### 1992-2004

#### Overview

We begin with an overview of the prevalence of self employment among full time career (FTC) workers from 1992 to 2004. As these workers began leaving their career jobs, the percentage of those working who were self employed increased substantially (Figure 1). At the time of the 1992 HRS survey, 21% of the men on a FTC job were self employed. Among those who continued working, this percentage rose steadily to 35% by 2004. The largest increases were observed between 2000 and 2004, when the percentage for men increased by more than 7 percentage points. A similar pattern was observed among women, although the percentages were about one half those of the men. Among women with FTC jobs in 1992 and still working in 2004, about 18% were self employed in their 2004 job, up from 10% in 1992.

The rise in self employment with age comes from two factors. First, self-employed workers transition out of the labor force more slowly than wage-and-salary workers do. Second, more wage-and-salary workers move into self employment as they age than vice versa. As shown in Figure 2, 65% of the men who were self employed in 1992 were still working by 2004, compared to only 40% of the wage-and-salary men. A similar pattern, though a smaller difference, existed between the self-employed and wage-and-salary women.

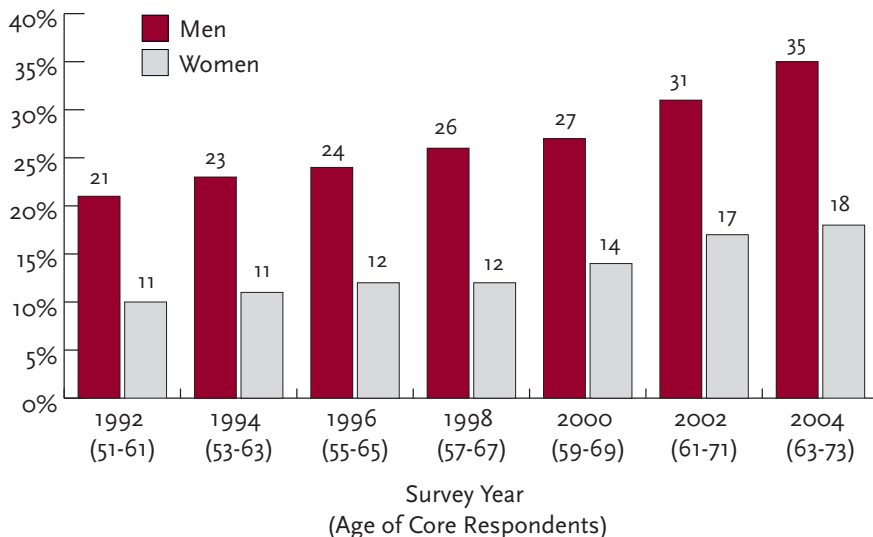
The second explanation for the increase in self employment as workers age reflects that more wage-and-salary workers shift to self employment than the reverse. Figure 3 shows that, in percentage terms, self-employed men in our sample moved into wage-and-salary work at about twice the rate that wage-and-salary men moved into self employment. But because there are so many more wage-

## DESCRIPTION OF SAMPLE

We use the Social Security Administration's Health and Retirement Study (HRS) to examine work histories and to identify job transitions of older wage-and-salary and self-employed individuals. The HRS is a nationally representative panel data set designed to aid understanding of the antecedents and consequences of retirement, the relationships among health, income and wealth, and the patterns of wealth accumulation and consumption over time.<sup>8</sup> The HRS began in 1992 with interviews of over 12,600 people aged 51 to 61 years (known as the Core), and the spouses of those married, whatever their age. The sample has been re-interviewed every other year since 1992.

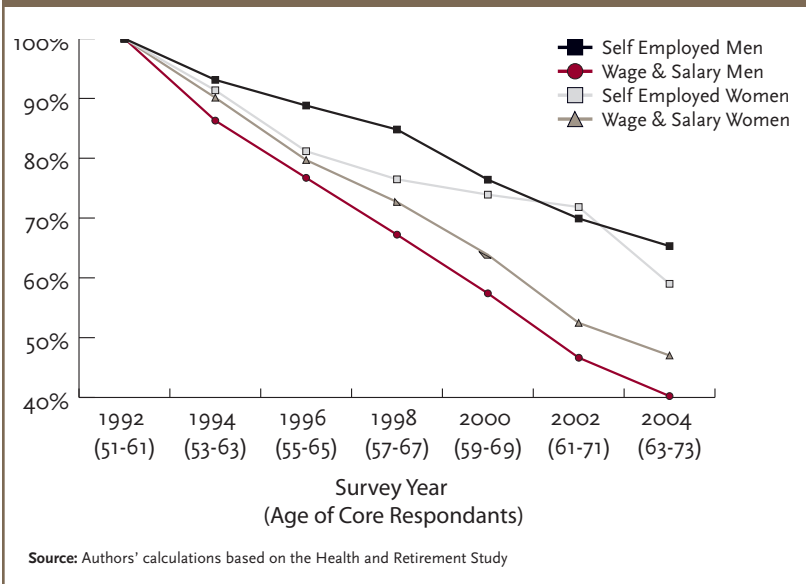
We focus on those workers who held full-time career (FTC) jobs at the time of the first interview. We define a full-time career job as one that consists of at least 1,600 hours per year ("full time") and that lasts ten or more years ("career"). Jobs that follow FTC jobs that do not meet these criteria (i.e., are either part-time or less than 10 years in duration) are considered bridge jobs. Slightly more than one half of the men ( $n = 3,057$ ) and about one third of the women ( $n = 2,513$ ) were on a FTC job in 1992. Approximately 16% of this sample (21% of the men and 10% of the women) were self employed on this 1992 job.

Figure 1: Percentage Self Employed Among Men and Women Who Held FTC Jobs in 1992



Source: Authors' calculations based on the Health and Retirement Study

**Figure 2: Percentage Working Among Men and Women Who Held FTC Jobs in 1992**



and-salary than self-employed workers - about 4 to 1 - the net impact was a rise in the number of self employed. A similar trend is observed among the FTC women.

With regard to an individual's transition from a FTC job, four scenarios are possible: an individual can (1) remain on the FTC job, (2) move to a self-employed job, (3) move to a wage-and-salary job, or (4) exit the labor force.<sup>10</sup>

**Figure 3: Percentage of Men and Women with FTC Jobs Who Switched Work Status between 1992 and 2004, by Gender**



## SELF EMPLOYMENT IN THE U.S. AND ENGLAND

Retirement incentives from defined-benefit pension plans often encourage wage-and-salary workers to retire earlier than self-employed workers. Employer-provided health insurance also has an impact, "locking" individuals into wage-and-salary employment, or work in general, until workers reach age 65 when they become eligible for Medicare. To explore the impact of pensions, health insurance, and other covariates of retirement among self-employed and wage-and-salary workers, Zissimopoulos, Maestas, and Karoly performed a cross-country comparison between the US and England.<sup>9</sup> Specifically, they compared institutional arrangements in the US relating to pensions and health insurance to those in England using the Health and Retirement Study and an English equivalent, the English Longitudinal Survey of Ageing.

One of the key differences between the US and England is that, in the United States, pensions typically consist of Social Security and employer-provided defined-benefit and defined-contribution plans, while in England pension income consists of a two-tiered defined-benefit and/or defined-contribution pension. Another difference is that workers usually have employer-provided health insurance in the United States whereas healthcare is provided by the state in England. These differences between the US and England can be used to explore the way in which pensions and healthcare impact self-employment and work decisions later in life.

Zissimopoulos, Maestas, and Karoly noted that self-employed workers in England retired earlier than those in the U.S. The authors also observed that, in the US, substantial differences in health insurance exist by self-employment status while these differences do not exist in England. The authors found that, when access to health insurance was not tied to employment,

## Wage-and-Salary Trends

Among the men who were on a wage-and-salary FTC job in 1992, only 11 percent were still on that job in 2004, while 10% transitioned into a self-employed position, 32% moved to another wage-and-salary job, and 47% left the labor force directly from FTC employment (Figure 4). Among the women on a wage-and-salary FTC job in 1992, 17% were still on it in 2004, while 8% moved to self employment, 36% to another wage-and-salary job, and 39% left the labor force.

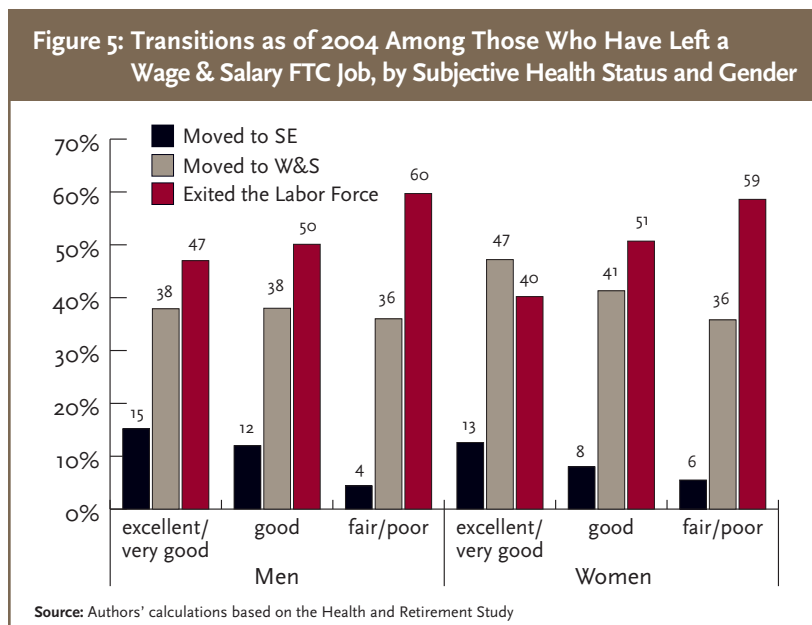
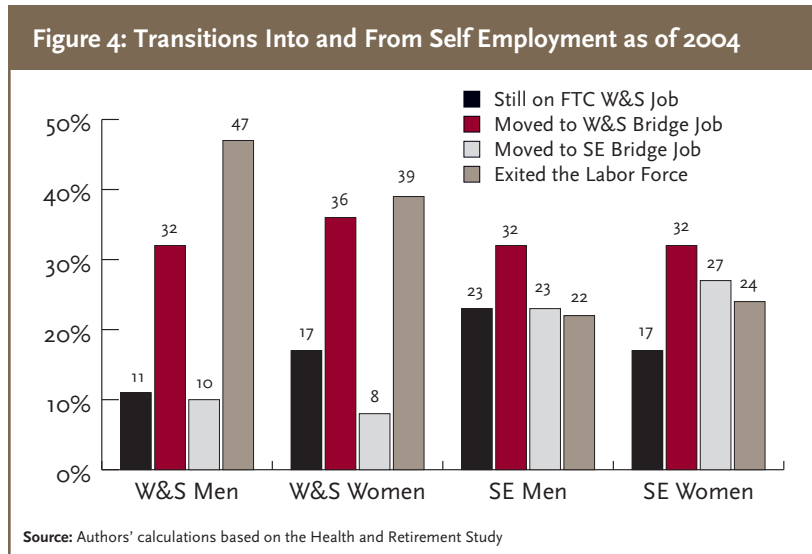
## Self Employed Trends

Among their counterparts who were self employed on their 1992 FTC job, 23% of men were still on that job in 2004, while 23% transitioned into a self-employed bridge job, 32% moved to a wage-and-salary job, and 22% left the labor force directly from FTC self employment. Among the women on a self employed FTC job in 1992, 17% were still on it in 2004, while 27% moved to another self-employed job, 32% transferred to a wage-and-salary position, and 24% left the labor force.

the gap in retirement rates between U.S. and England self-employed workers was reduced. Regarding pensions, the authors found that the incentives in defined-benefit plans in both countries encouraged workers to retire earlier than if these incentives were not in place, and that in general only wage-and-salary workers possessed DB pensions.

The authors also found some other notable differences between those who are self employed in the US and those who are self employed in England. First, in the U.S., 25% of self-employed workers report excellent health compared to 17% of wage-and-salary workers. The corresponding values in England were only 11% of the self employed and 9% of wage-and-salary employees. Second, in the U.S., 32% of self-employed workers work part time while only 17% of wage-and-salary workers are part time. In England, there was no difference between self employed and wage-and-salary workers with respect to part time status – 35% worked part time.

The UK and England experiences with self employment later in life indicate that financial incentives can explain some, but not all, of the differences between the two countries.



## Demographic and Economic Considerations

### Health

Health is clearly an important factor in determining the transition to self employment. Wage-and-salary workers, both men and women, were much less likely to become self employed if they described their health as fair or poor compared to those who rated it as either excellent or very good (Figure 5).

### Educational Status

Another large discrepancy among the men was by educational status (Figure 6). Transitions into self employment were relatively common among college-educated men, where 22% who had left a FTC wage-and-salary job transitioned to self employment. Conversely, among wage-and-salary men with less than a college degree, only 10% moved to self employment when they left their FTC job. Among women in the sample who left wage-and-salary career jobs, 15% of those with college degrees transitioned to a self-employed position compared to only 9% of those without a college degree.

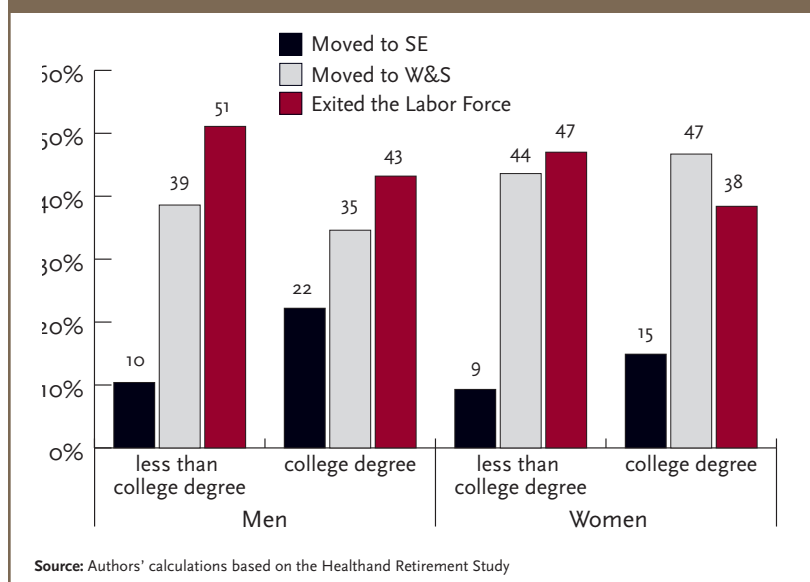
This discrepancy by educational attainment may be caused not by education per se, but by different inherent skills among those with and without college degrees. Those with a college experience may be more likely to possess the skills required to operate a business. This finding may also indicate another relationship. Those with college degrees have had, on average, a lifetime of higher earnings than those without a college degree, and these higher earnings may have provided the financial capital needed to begin self employment.<sup>11</sup>

Differences also existed by age, marital status, and spouse's employment status, albeit to a lesser extent than by health and educational attainment.

## WHAT ARE BRIDGE JOBS?

A bridge job is one that bridges the gap between full-time career employment and complete labor force withdrawal. With retirement becoming more of a process than a single event, bridge jobs are an important part of the way Americans retire. In fact, the majority of individuals who left full-time career employment in recent years transitioned to a short-duration or part-time job before exiting the labor force entirely.<sup>12</sup> Bridge jobs can fill many needs for different workers. Rather than retiring directly from a career job, some workers who are financially well-prepared for retirement may transition to a job that they have always wanted – a “dream” job – even though they no longer need to work. Meanwhile, other workers may have to leave a career job because of illness or an inability to continue to perform the required tasks. These workers may take a bridge job to supplement their retirement income, which may not be enough on which to live. Self-employed bridge jobs may be a particularly useful mechanism for workers to use their skills to choose when and how they will work.

Figure 6: Transitions as of 2004 Among Those Who Have Left a Wage & Salary FTC Job, by Education Level and Gender



## Wage

Two very important and related economic characteristics examined in this study were the wage rate and the occupational status of the FTC job. High earning wage-and-salary men were more likely to transition into self employment (Figure 7). Fewer than 10% of those who earned less than \$10 per hour (in 1992 dollars) did so, compared to about 18% of those who earned between \$20 and \$50 per hour. Among women, differences by wage status were smaller in magnitude, although the general trend was the same - those in the highest wage category were (slightly) more likely to switch into self employment. Among both men and women, this result is consistent with the hypothesis that financial liquidity is an important factor in the transition to self employment. Those with high FTC job wages are probably the least likely to be financially constrained and we find they are most likely to move into self employment.

## Occupational Status

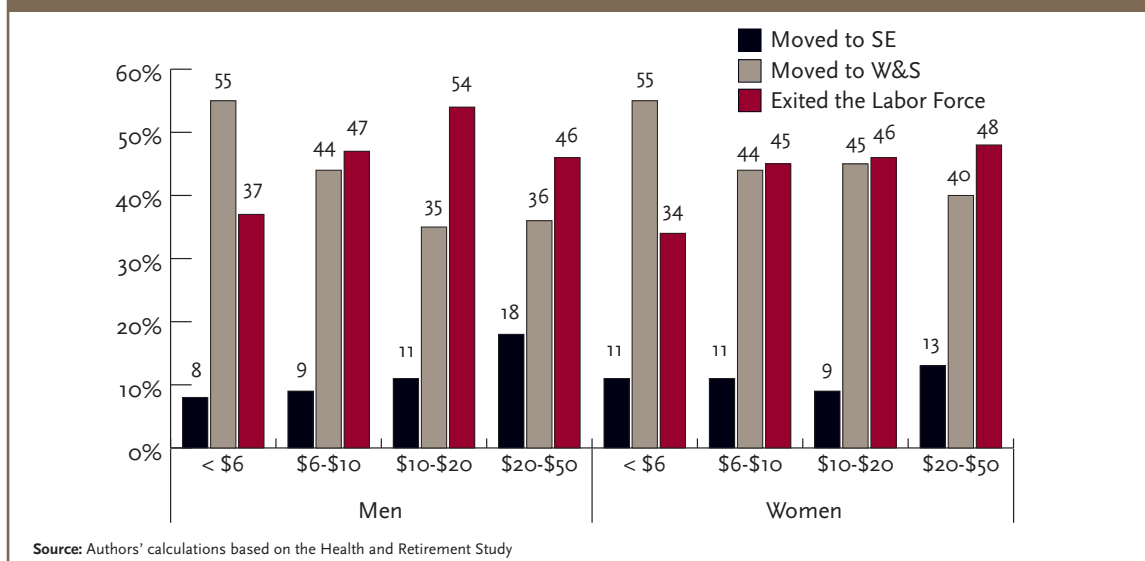
Occupational status was also a strong indicator of a transition into self employment (Figure 8). About 19% of men with a white-collar, highly skilled wage-and-salary FTC job transitioned to self employment, compared to only 5% of men at the other end of the spectrum, with blue-collar, not highly skilled jobs. Those in the middle (white collar, not highly skilled, and blue collar, skilled) fell neatly in between (16% and 10%).

The impact of occupational status was different for women. Wage-and-salary women in blue-collar, non-highly-skilled jobs were more likely than those in white-collar, highly-skilled jobs to switch into self employment. Further investigation found that among women who transitioned from non-highly-skilled blue-collar jobs, those who became self employed were younger, more likely to have a college degree, more likely to be married, and more likely to have children at home.

## HOW DO LIQUIDITY CONSTRAINTS AFFECT SELF EMPLOYMENT?

Many workers would like to start their own business but do not have the necessary capital to do so. These workers are said to face binding liquidity constraints.<sup>13</sup> In a seminal article Evans and Jovanovic found that many would-be self-employed workers are liquidity constrained. One finding that is consistent with this explanation is that wealthy individuals are more likely to become self employed than those who are less wealthy. Holtz-Eakin, Joulfaian, and Rosen investigated the impact of an exogenous shock to wealth, namely inheritances, on both the probability of becoming self employed and the likelihood of remaining self employed.<sup>14</sup> They concluded that those whose received inheritances were more likely to become self employed and that those who received larger inheritances were more likely to remain profitably self employed. Therefore, liquidity constraints appear to inhibit some workers who would otherwise become entrepreneurs from transitioning to self employment. Many older wage-and-salary older workers may want to become self employed but are simply unable to do so because they lack the financial means to set out on their own.

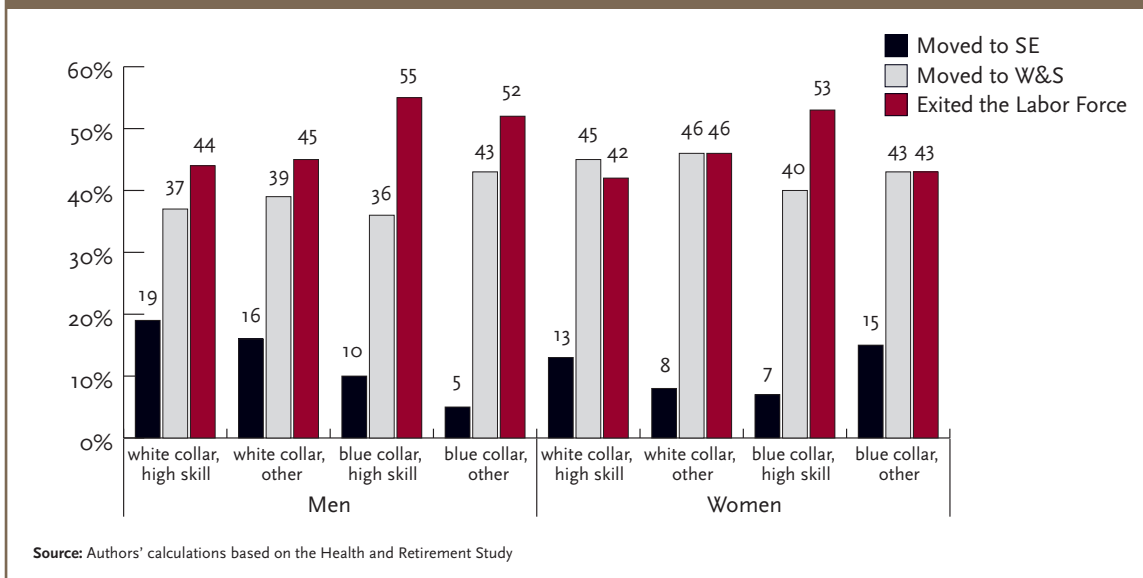
Figure 7: Transitions as of 2004 Among Those Who Have Left a Wage & Salary FTC Job, by Hourly Wage on FTC Job and Gender



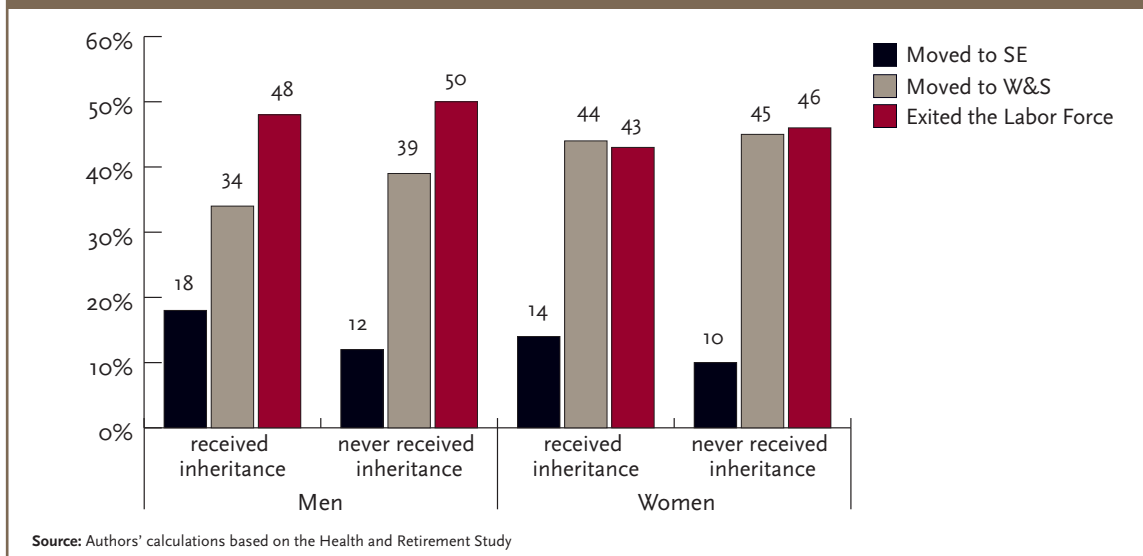
## Inheritance Status

Finally, Figure 9 analyzes inheritance status. Research has found that workers who receive an inheritance, and in particular a large inheritance, are more likely to become self employed than others.<sup>15</sup> In our sample, nearly 18% of men who had received an inheritance and left a FTC job transitioned to a self-employed position compared to less than 12% of those men who had not received an inheritance. The corresponding values for women are 14% and 10%. Much like the wage and occupation analyses in Figures 6 and 7, increased wealth and liquidity that arise from receiving an inheritance lead to a greater likelihood of transitioning to self employment after leaving a FTC wage-and-salary job.

**Figure 8: Transitions as of 2004 Among Those Who Have Left a Wage & Salary FTC Job, by Occupation Status of FTC Job and Gender**



**Figure 9: Transitions as of 2004 Among Those Who Have Left a Wage & Salary FTC Job, by Inheritance Status and Gender**



## CONCLUSION

Self employment among the working population increases substantially as workers approach retirement age. According to data from the Health and Retirement Study, about 20% of men aged 51 to 61 on a career job in 1992 were self employed, already a sizable proportion. Twelve years later, more than one third of those still working were self employed - an increase of more than one half. Among women, self employment rose from about 10% to more than 15%, also an increase of one half. The rise in self employment occurs because self-employed workers tend to stay in the labor force longer than wage-and-salary workers do and because more wage-and-salary workers switch into self employment later in life than vice versa. Some of the key determinants of these transitions are health status, educational attainment, and wage rate and occupational status on the career job. Although not the focus of this Issue Brief, we also observed considerable cross-over among those leaving FTC self-employed jobs for wage-and-salary employment.

The degree to which older Americans switch from wage-and-salary employment to self employment is interesting and important. Older workers exhibit a great deal of flexibility in their work decisions and appear willing to take on substantial risks later in life. Older workers are more likely than their younger counterparts to have access to investment capital, and their lifetime of experience may help them avoid many of the pitfalls associated with running a business that may ensnare younger, less experienced workers.

Policymakers and employers have much to gain by understanding the self-employment transitions of older Americans, because the decision to continue working late in life is likely linked to the type of work people will be doing. Self employment can provide older workers with the flexibility they desire. If needs such as these are met, many older workers may continue to work later in life and continue to be a valuable resource as the population ages.

## IMPLICATIONS FOR EMPLOYERS

This Issue Brief finds that many self-employed workers transition to wage-and-salary bridge jobs before retirement. This transition presents employers with an opportunity to hire self-motivated workers who have the skills that are required to own and operate their own businesses. Another potentially large benefit is that these individuals often employed workers in their own businesses and, as a result, they have experience making management-type decisions. Firms may be able to attract these high skill workers by tailoring positions that utilize their existing talents while presenting them with new challenges. Project-oriented work with flexible work time and work place options may be just the characteristics that many once self-employed older workers desire.

Likewise, retention of valuable workers before they transition to self-employed bridge jobs may become a goal of firms as the baby boom begins its transition from the labor force. Those same job characteristics that make self employment so attractive can be used to maintain those employee skills that employers demand. When older workers are included in exciting projects and when work-time flexibility exists, many will choose to remain with their existing employer longer than they otherwise would.<sup>16</sup>

Michael D. Giandrea, Ph.D. is a research economist in the Office of Productivity and Technology at the U.S. Bureau of Labor Statistics. He received his B.S. from Bates College and his Ph.D. in economics from Boston College. His work includes research into the determinants of retirement, self employment among older workers, and the effects of mergers among firms on firm level productivity growth.

Kevin E. Cahill, Ph.D., is an associate at Analysis Group, Inc. in Boston. He received his B.A. in mathematics from Rutgers College and his Ph.D. in economics from Boston College. Dr. Cahill currently writes on topics related to the economics of aging.

Joseph F. Quinn, Ph.D. is a Professor of Economics at Boston College. Professor Quinn received his B.A. in economics from Amherst College and his Ph.D. in economics from the Massachusetts Institute of Technology. His research interests include labor economics, the economics of aging, and Social Security reform.

The Sloan Center on Aging & Work at Boston College was founded in 2005 with a multi-million dollar grant from the Alfred P. Sloan Foundation. The Center partners with workplace decision-makers in evidence-based research on employer and employee responses to the increasingly global multi-generational workforce. These collaborations focus on quality of employment with the aim to inform employers with research data to attract, engage and retain high quality industry talent. As of 2008, the Center has three research streams – the US National Initiatives, the State Initiatives and the Global Initiatives. Their collective mission is to gather information and collaborate with leaders in the public, non-profit and business sectors in an effort to leverage today's multi-generational workforce and globalization as competitive advantages in the 21st century economy.

\* All views expressed in this paper are those of the authors and do not necessarily reflect the views or policies of the U.S. Bureau of Labor Statistics.

#### References:

- 1 Burkhauser, R. V., & Quinn, J. F. (1997). Implementing pro-work policies for older Americans in the twenty-first century (Working Paper No. 378). Chestnut Hill, MA: Boston College Department of Economics. Retrieved from "<http://fmwww.bc.edu/EC-P/WP378.pdf>"
- 2 Cahill, K. E., Giandrea, M. D., & Quinn, J. F. (2006). Retirement patterns from career employment. *The Gerontologist*, 46(4), 514-523.
- 3 Hipple, S. (2004). Self-employment in the United States: An update. *Monthly Labor Review*, 127(7), 13-23. Retrieved from "<http://www.bls.gov/opub/mlr/2004/07/art2full.pdf>"
- 4 Social Security Administration. (2007). Fact Sheet: Social Security. Washington, DC: Social Security Administration. Retrieved from "<http://www.ssa.gov/pressoffice/factsheets/basicfact-alt.pdf>"
- 5 Branchflower and Oswald found that self-employed workers exhibited higher levels of both job and life satisfaction than wage-and-salary employees. Blanchflower, D. G., & Oswald, A. J. (1998). What makes an entrepreneur? *Journal of Labor Economics*, 16(1), 26-60.
- 6 Pitt-Catsouphes, M., & Smyer, M. A. (2005). Businesses: How are they preparing for the aging workforce? (Issue Brief No. 02). Chestnut Hill, MA: Boston College Center on Aging & Work/Workplace Flexibility. Retrieved from "[http://agingandwork.bc.edu/documents/IB02\\_BusinessPreparing.pdf](http://agingandwork.bc.edu/documents/IB02_BusinessPreparing.pdf)"
- 7 Most existing literature on self employment stresses liquidity issues for potential entrepreneurs. Notable among these articles is Evans, D. S. & Jovanovic, B. (1989) An Estimated Model of Entrepreneurial Choice under Liquidity Constraints. *The Journal of Political Economy*, 97(4), 808-827. Other authors consider employee experience and human capital in addition to liquidity aspects of self employment, notable among many others is Dunn, T. & Holtz-Eakin, D. (2000) Financial Capital, Human Capital, and the Transition to Self-Employment: Evidence from Intergenerational Links. *Journal of Labor Economics*, 18(2), 282-305.
- 8 Juster, F. T., & Suzman, R. (1995). An overview of the health and retirement study. *Journal of Human Resources*, 30(Suppt), S7-S56.
- 9 Zissimopoulos, J., Maestas, N., & Karoly, L. A. (2007). The effect of retirement incentives on retirement behavior: Evidence from the self-employed in the United states and England. Santa Monica, CA: RAND. Retrieved from "[http://rand.org/pubs/working\\_papers/2007/RAND\\_WR528.pdf](http://rand.org/pubs/working_papers/2007/RAND_WR528.pdf)"
- 10 A respondent with a wage-and-salary FTC job is classified as having transitioned to self employment if the respondent was self employed on any bridge job following FTC employment. A respondent who was self employed on a FTC job is classified as having transitioned to wage-and-salary employment if the respondent had any wage-and-salary bridge job following FTC employment.
- 11 Evans and Jovanovic (1989), among others, found that liquidity constraints are often binding on would-be self-employed workers. Those with higher wealth are more likely to start a business and more likely to be successful in that business.
- 12 Cahill, K. E., Giandrea, M. D., & Quinn, J. F. (2007). Down shifting: The role of bridge jobs after career employment. (Issue Brief No. 6). Chestnut Hill, MA: Boston College Center on Aging & Work/Workplace Flexibility. Retrieved from "[http://agingandwork.bc.edu/documents/IB06\\_DownShifting\\_003.pdf](http://agingandwork.bc.edu/documents/IB06_DownShifting_003.pdf)"
- 13 Evans and Jovanovic (1989).
- 14 Holtz-Eakin, D., Joulfaian, D., & Rosen, H. S. (1994). Sticking it out: Entrepreneurial survival and liquidity constraints. *Journal of Political Economy*, 102(1), 53-75. Holtz-Eakin, D., Joulfaian, D., & Rosen, H. S. (1994). Entrepreneurial decisions and liquidity constraints. *RAND Journal of Economics*, 25(2), 334-347.
- 15 Holtz-Eakin, D., Joulfaian, D., & Rosen, H. S. (1994).
- 16 Helman, R., Copeland, C., VanDerhei, J., & Salisbury, D. (2008). EBRI 2008 Recent Retirees Survey: Report of Findings. Employee Benefit Research Institute Issue Brief No. 319. Retrieved from "[http://www.ebri.org/pdf/briefspdf/EBRI\\_IB\\_07-2008.pdf](http://www.ebri.org/pdf/briefspdf/EBRI_IB_07-2008.pdf)"

---

For previous publications, visit our website at [www.bc.edu/agingandwork](http://www.bc.edu/agingandwork)

### Issue Briefs

Issue Brief 1: Older Workers: What Keeps Them Working?

Issue Brief 2: Businesses: How Are They Preparing For the Aging Workforce?

Issue Brief 3: Getting the Right Fit: Flexible Work Options and Older Workers

Issue Brief 4: How Old Are Today's Older Workers?

Issue Brief 5: One Size Doesn't Fit All: Workplace Flexibility

Issue Brief 6: Down Shifting: The Role Of Bridge Jobs After Career Employment

Issue Brief 7: Civic Engagement: Volunteering Dynamics and Flexible Work Options

Issue Brief 8: Does Health Insurance Affect The Employment of Older Workers?

Issue Brief 9: The 21st Century Multi-Generational Workplace

Issue Brief 10: Today's Multi-Generational Workforce: A Proposition of Value

Issue Brief 11: Responsive Workplaces for Older Workers: Job Quality, Flexibility and Employee Engagement

Issue Brief 12: Generational Differences in Perceptions of Older Workers' Capabilities

Issue Brief 13: Quality of Employment and Life Satisfaction: A Relationship that Matters for Older Workers

Issue Brief 14: The Interlocking Careers of Older Workers and Their Adult Children

### Research Highlights

Research Highlight 1: Context Matters: Insights About Older Workers From the National Study of the Changing Workforce

Research Highlight 2: The Diverse Employment Experiences of Older Men and Women in the Workforce

Research Highlight 3: The Benchmark Study, Phase I of The National Study of Business Strategy and Workforce Development

Research Highlight 4: The National Study, Phase II of The National Study of Business Strategy and Workforce Development

*This work was supported by the Sloan Center on Aging and Work: Workplace Flexibility at Boston College (Sloan grant #5000719).*