

BUSINESS DYNAMICS STATISTICS BRIEFING: Where Have All the Young Firms Gone?

Sixth in a series of reports using data from the
U.S. Census Bureau's Business Dynamics Statistics

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The Foundation of Entrepreneurship

Where Have All the Young Firms Gone?

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1. University of Maryland and NBER, U.S. Census Bureau, and U.S. Census Bureau. The analysis in this paper uses only public domain data from the Business Dynamics Statistics (BDS). We thank E.J. Reedy for providing useful comments on an earlier draft.

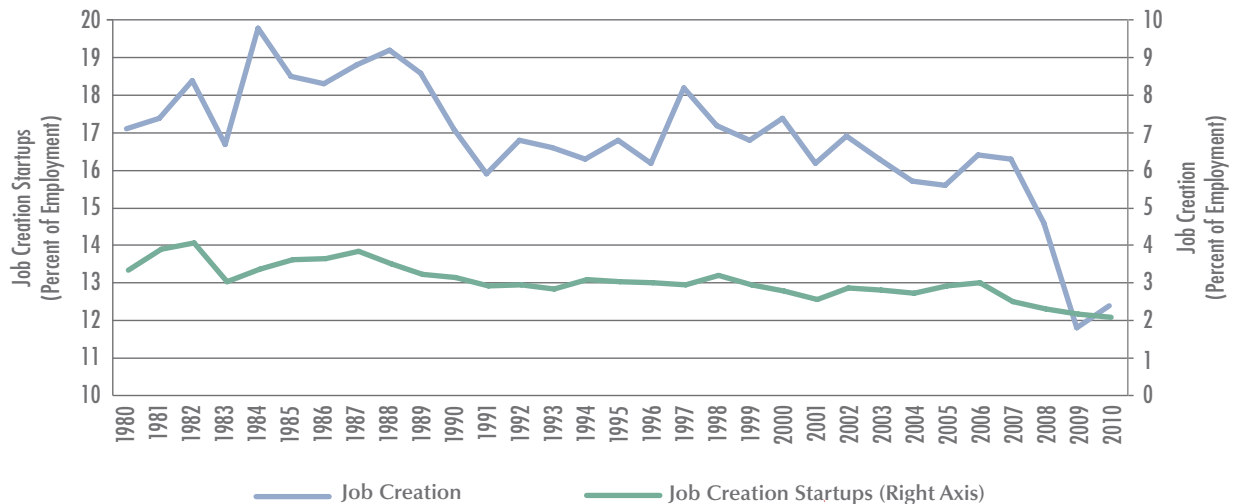
The Census Bureau’s Business Dynamics Statistics (BDS)² provides data on business dynamics for U.S. firms and establishments with paid employees.³ This briefing highlights some key features of the most recent BDS update, which now has data through 2010. As the most complete public-use dataset allowing for the analysis of business dynamics in the United States, the BDS is a key source of knowledge about the changing state, as well as the national, economy.

The new BDS data release shows that, in 2010, 394,000 startups created 2.3 million jobs (these were not simply establishment openings but new firms whose establishments also were new to the economy). This reflects substantial job creation in a time of anemic overall economic activity. Over the

same period from March 2009 to March 2010,⁴ the net job creation from all U.S. private sector firms was -1.8 million jobs. Without the contribution of business startups, the net employment loss would have been substantially greater.

Previous work using the BDS has highlighted the critical contribution of startups to job creation (see, e.g., Haltiwanger, Jarmin, and Miranda [forthcoming]). However, a potentially troubling trend identified from earlier BDS releases is that the pace of business startups has exhibited a long-run decline that dates back to the 1980s (see, e.g., Haltiwanger, Jarmin, and Miranda [2011] and Litan and Reedy [2011]).⁵ The newly released BDS shows that this trend has continued through 2010. Figure 1 shows the long decline in the pace of overall job creation in the United

Figure 1
Annual Job Creation in U.S. Private Sector—
Overall and from Startups



2. The BDS was developed at the Census Bureau’s Center for Economic Studies, with support from the Census Bureau and the Ewing Marion Kauffman Foundation. The current update also received support from the Small Business Administration. Statistics on business dynamics are provided at an economy-wide level and by firm size, firm age, sector, and state. Starting early in 2012, the BDS is released annually. For the first time, business dynamics also are provided by establishment size and establishment age.

3. The BDS does not include non-employer firms and, as such, this brief does not speak to job creation from non-employer businesses.

4. In the BDS, net and gross flows are measured from March to March. The net growth rate of employment from March 2008 to March 2009 in the U.S. private sector was -4.9 percent, and was -1.6 percent from March 2009 to March 2010.

5. Another recent study that uses the BDS to explore the role of startups for job creation is Strangler and Kedrosky (2010).

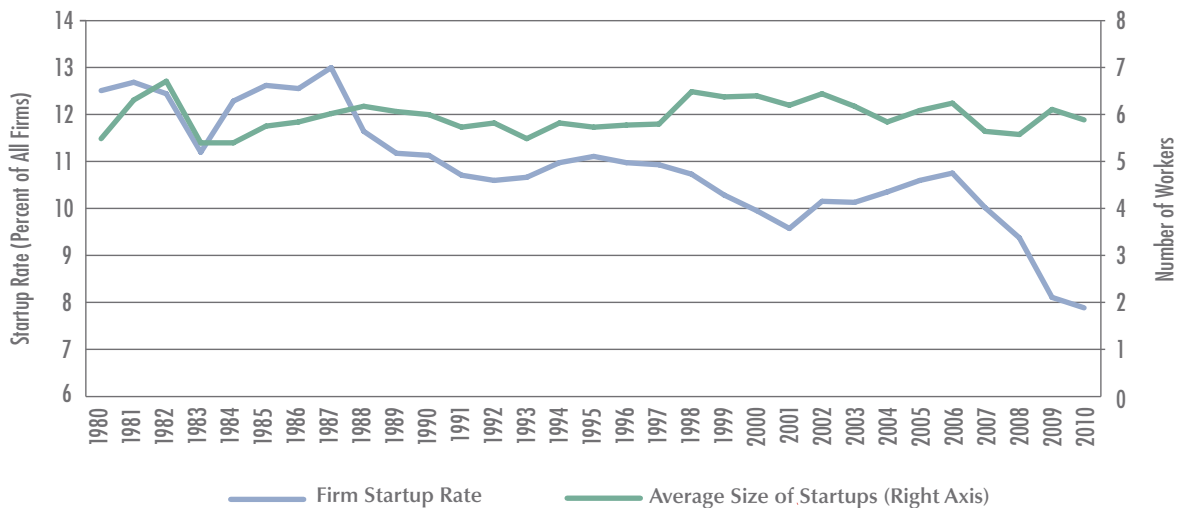
States accompanied by a declining rate of job creation from business startups. It is evident that the decline in job creation from startups accelerated in the recent recession.

The declining job creation from business startups reflects a declining firm startup rate. Figure 2 shows that the startup rate of firms has declined from as high as 12 percent to 13 percent (as a percentage of all firms) in the 1980s to 7 percent or 8 percent in recent years. Figure 2 also shows that there has been no discernible trend in the average size of a new firm.⁶ Figure 2 shows that the average firm startup is well under ten workers.

A consequence of this drop in the pace of business startups is that the share of activity accounted

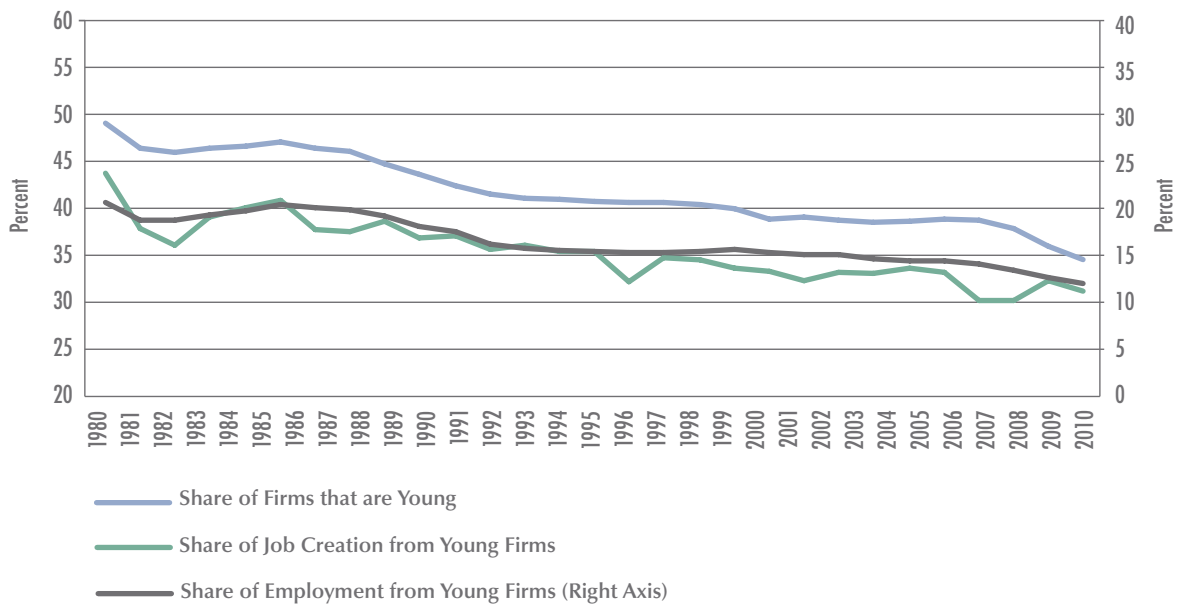
for by young firms (defined here as firms aged five or less) has steadily declined over time. In addition, consistent with the patterns for startups, there has been acceleration in the decline of activity accounted for by young firms in recent years. Figure 3 shows the percent of young firms, their employment, and their job creation as a share of the total number of firms, economy-wide employment, and overall job creation. From the early 1980s, the share of young firms has declined from close to 50 percent to less than 35 percent in 2010. This decline reflects both a long-run secular decline and accelerated decline in the recent recession. Figure 3 also shows an accompanying decline in the share of employment and share of job creation accounted for by young firms. The share of job creation from young firms has fallen from above

Figure 2
Declining Pace of Firm Startups, U.S. Private Sector, BDS



6. This pattern might appear to contrast with recent findings from Reedy and Litan (2011), who emphasize the apparent smaller declining size of new establishments over time, but we note that our focus here is on new firms and not new establishments. There is a high pace of establishment openings from existing firms. For example, Haltiwanger, Jarmin, and Miranda (forthcoming) show that job creation from new establishments from existing firms is about as large as job creation from new firms. So distinguishing between firms and establishments is critical for both conceptual and measurement reasons. Note that Reedy and Litan (2011) also show that there is a discrepancy between Census and BLS evidence on the time series patterns of the average size of new establishments. BLS evidence shows a more evident pattern of decline in the average size of new establishments. These discrepancies in establishment patterns are an open area of research. Also, note that Reedy and Litan (2011) also show what we show in Figure 2—no discernible trend in the size of new firms from the BDS (although this is not their emphasis).

Figure 3
Declining Share of Activity from Young Firms
(Firm Age Five or less) U.S. Private Sector, BDS

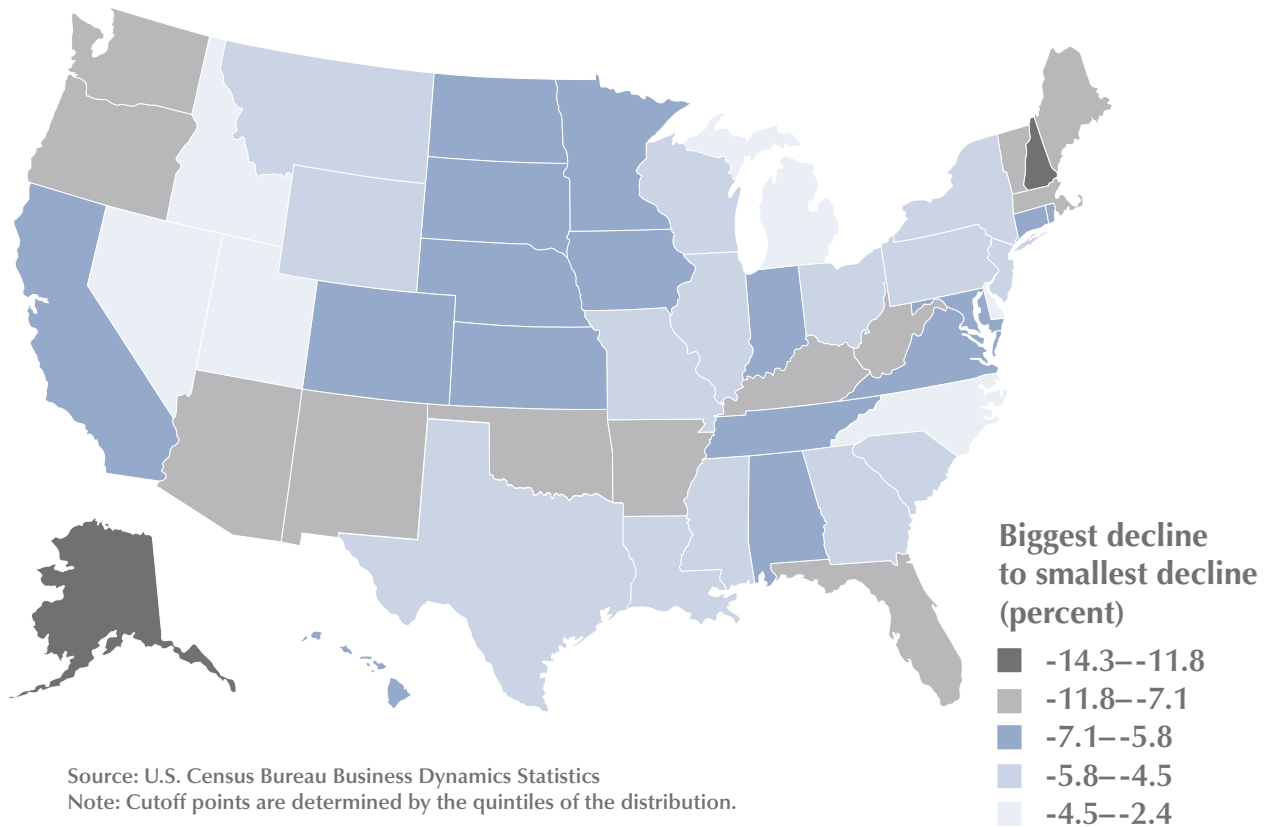


40 percent in the 1980s to around 30 percent in recent years. The share of employment accounted for by young firms has fallen from more than 20 percent in the 1980s to as low as 12 percent in 2010.

Examining the contributions of young firms to business activity and job creation has been highlighted in recent studies that show the disproportionate contribution of both startups and high-growth young firms to job creation (see Haltiwanger, Jarmin, and Miranda [forthcoming]). Figures 1 through 3 highlight that the business activity and job creation from startups and young firms has declined substantially from the 1980s through 2010. These patterns raise a variety of questions about the underlying forces shaping these changes, but, more generally, raise questions about whether the United States is becoming less entrepreneurial given the lower pace of startups and the smaller share of activity accounted for by young firms.

Addressing these questions is beyond the scope of this brief. However, it is useful to examine how widespread these changes are across regions and states. Narrowing in on the decline from the national to the state-level data, which also are available in the BDS through 2010, Figure 4 shows that the declines have been ubiquitous, but with varying magnitude of decline across states. Comparing the changes from the 1987–1989 to 2004–2006 business cycle peaks, the biggest declines at the state level ranged from a decline of 7 percentage points to 14 percentage points, while the smallest declines were a more modest 2 percentage points to 5 percentage points. While there is no distinct regional pattern, there is a common pattern to those states with the largest declines—they are the states that had some of the highest initial shares of business activity accounted for by young businesses in the 1980s. That is, there is a strong inverse correlation (about -0.55) between the initial share of activity accounted for by young

Figure 4
Change in the Percent of Employment Accounted for by
Young Firms by State: Peak (1987–1994/2004–2006)



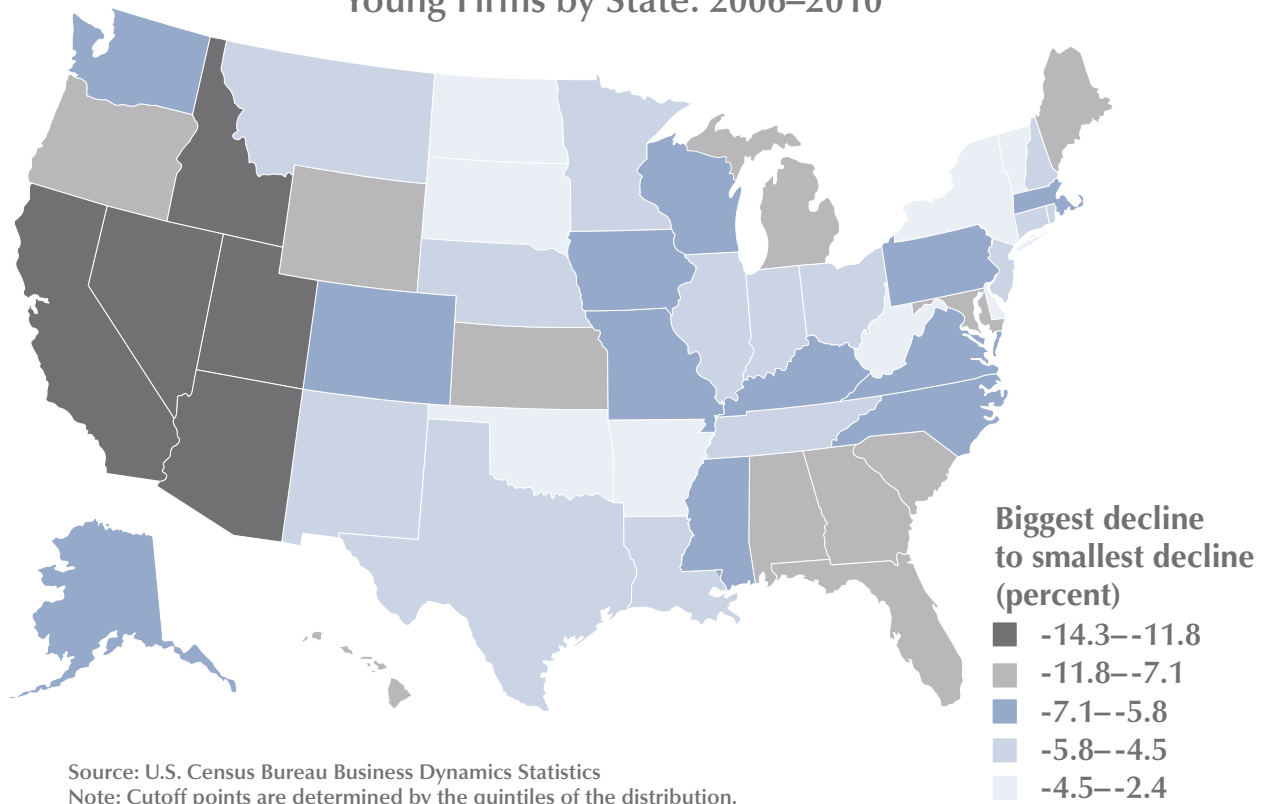
Source: U.S. Census Bureau Business Dynamics Statistics
Note: Cutoff points are determined by the quintiles of the distribution.

businesses and the secular decline. In that respect, there has been a marked pattern of convergence in the activity accounted for by young businesses across states. But the convergence has taken the form of all states becoming less entrepreneurial (in the sense of a smaller share of activity from young firms) with the most entrepreneurial states exhibiting the largest declines.

Looking more closely at the 2006 to 2010 period, Figure 2 shows that the decline in the pace of business startups at the national level accelerated in the recession and has not yet recovered. Figure 3 shows that, at the national level, the share of employment

in young firms declined from 14.4 to 12.0 percent (a decline of 2.4 percentage points). Using the state-level data, Figure 5 shows that the cyclical declines in young business activity have been shared by all states. However, in terms of this latest cyclical decline, there are discernible regional patterns. The largest declines are concentrated in the West, Southwest, and South. These are all regions hit especially hard during the recession, so, in that respect, these regional patterns are not surprising. The correlation between the change in the share of employment accounted for by young firms and the change in the net growth rate of the state over the 2006 to 2010 period is 0.63. That is, the

Figure 5
Change in the Percent of Employment Accounted for by
Young Firms by State: 2006–2010



states with the greatest net contractions in the Great Recession also exhibited the largest decline in the share of activity accounted for by young businesses.

It is an open question why the United States has experienced the secular and cyclical decline in the activity and job creation from startups and young firms. Without knowing the sources of these declines, it is, of course, impossible to draw inferences about the implications of these declines for U.S. economic performance. However, we note that a hallmark of the U.S. economy often cited by analysts and policymakers is the high pace of business dynamism. A core aspect of that dynamism has been a robust pace of business startups accompanied by a rich “up or out” dynamic of U.S. businesses (see Haltiwanger, Jarmin, and Miranda

[forthcoming] and Haltiwanger [2012]). Much evidence shows this dynamism has contributed substantially to U.S. productivity and job growth. Historically, startups have contributed substantially to job creation by themselves. While many young businesses fail, the young businesses that have survived have exhibited high average growth rates (with the latter dominated by the most rapidly growing young businesses). In addition, the evidence shows that the high-growth surviving young firms have contributed substantially to productivity growth. While we don’t yet know the reasons, the evidence presented here on the secular and cyclical declines implies that, if nothing else, the contribution of such entrepreneurial activity has declined.

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