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Before the
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Workforce

*The Decline in Business Formation: Implications for
Entrepreneurship and the Economy*
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Chairman Hanna, Ranking Member Meng, and members of the committee, thank you for the opportunity to testify about a troublesome trend in entrepreneurship—the declining rate of new business creation.

As the world's largest private foundation dedicated to the study and promotion of entrepreneurship, the Ewing Marion Kauffman Foundation has been at the center of this issue for some time. Our financial commitments to data collection helped uncover this trend and our research has illuminated not only some possible explanations for the decline but also ways in which public policy can create an environment more conducive to business formation and growth.

Founded by late entrepreneur and philanthropist Ewing Marion Kauffman, the Kauffman Foundation is a private, nonpartisan foundation based in Kansas City, Missouri that aims to foster economic independence by advancing educational achievement and entrepreneurial success. At the Kauffman Foundation, we believe in the power of entrepreneurship not only to change individual lives, but also to create economic opportunities for many others in society.

New business creation is crucial to a healthy, vibrant economy for two reasons: job creation and innovation. Contrary to popular rhetoric, it is not small businesses, but rather new and young businesses that drive new job creation. Nearly all net new jobs are created by new and young companies.¹ Similarly, startups are responsible for a disproportionate share of innovative activity,² which creates not just wealth for the entrepreneur, but rising standards of living for all.³

¹ John Haltiwanger, Ron S. Jarmin and Javier Miranda, "Who Creates Jobs? Small vs. Large vs. Young," *Review of Economics and Statistics*, 2013, at http://www.mitpressjournals.org/doi/pdf/10.1162/REST_a_00288

² Natarajan Balasubramanian and Jeongsik Lee, "Firm age and innovation," *Industrial and Corporate Change*, 2008, at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1314522;

These twin functions of entrepreneurship comprise the core of U.S. economic preeminence. It is therefore concerning that we are witnessing a declining business creation rate, which threatens that position.

In the late 1970s, about 15% of all businesses were new; in 2011, that number hovered around 8%. Since 2000, even high-growth entrepreneurship has been in decline,⁴ as epitomized by a slowdown in the usually high-powered technology industry.⁵ Although some of this declining share is natural as the economy ages, the trend has been accelerated by lower entry rates of new firms coupled with higher exit rates for young firms. This declining business dynamism has been taking place for decades and across all sectors, raising serious concerns with regards to unemployment and lackluster wage growth.⁶

Despite this discouraging picture, there are sincere reasons for optimism. Although the best and most recent data on entrepreneurship are presently only available through 2011, early indicators point toward a full recovery of the business startup rate from the effects of the Great Recession.⁷ Looking more long-term, the demographic winds are shifting. Over the next 20 years, we will have more people than ever before in their 30s and 40s, the peak age for entrepreneurship.⁸ This new generation of entrepreneurs will also have unprecedented numbers of education and training resources available to them, which should make for a stronger entrepreneurial ecosystem. Finally, entrepreneurs of every stripe will have access to novel, potentially paradigm-

Jesper B. Sørensen and Toby E. Stuart, "Aging, obsolescence, and organizational innovation." *Administrative Science Quarterly*, 2000, at <http://www.jstor.org/stable/2666980>

³ Joel Mokyr, *The Lever of Riches* (Oxford University Press, 1990), pages 302-303

⁴ Ryan Decker, John Haltiwanger, Ron Jarmin and Javier Miranda, "The Secular Decline in Business Dynamism in the U.S.," Working Paper, 2014, at <http://faculty.chicagobooth.edu/workshops/applieecon/pdf/Haltiwangersecular.pdf>

⁵ John Haltiwanger, Ian Hathaway and Javier Miranda, "Declining Business Dynamism in the U.S. High-Technology Sector," The Kauffman Foundation, 2014, at: http://www.kauffman.org/~media/kauffman_org/research%20reports%20and%20covers/2014/02/declining_business_dynamism_in_us_high_tech_sector.pdf

⁶ Steven J. Davis and John Haltiwanger, "Labor Market Fluidity and Economic Performance," Jackson Hole Economic Policy Symposium Working Paper, September 2014, at <http://www.kc.frb.org/publicat/sympos/2014/083014-1.pdf>

⁷ Benjamin Ryan, "Starved of Financing, New Businesses Are In Decline," *Gallup*, September 4, 2014, at <http://businessjournal.gallup.com/content/175499/starved-financing-new-businesses-decline.aspx>

⁸ Dan Spulber and Dane Stangler, "The Age of the Entrepreneur: Demographics and Entrepreneurship," i4j Summit Working Paper, March 2013, at <http://i4j.org/wp-content/uploads/2013/05/i4jDaneStanglerDemographicsandEntrepreneurship-1.pdf>

shifting new forms of finance – crowdfunding remains in its infancy, but several platforms have shown both strong growth and even stronger potential.

These developments hold promise in reversing the long decline of new business creation, but the extent of their impact will depend on good public policy.

While more Americans will be entering the peak age for entrepreneurship, this same age group is also increasingly burdened by student loan debt, which may discourage potential entrepreneurs from starting a business.⁹ Moreover, it has been well-documented that college graduates who entered the workforce during and in the wake of the Great Recession faced bleak employment opportunities. Even now, the unemployment rate for college graduates age 21 to 24 is 8.5 percent.¹⁰

Tackling debt and delayed employment issues would boost entrepreneurship by reducing the financial constraints on younger entrepreneurs. Since young firms disproportionately employ young workers, and also pay a premium to young employees relative to older firms,¹¹ the additional new and young businesses would also provide more plentiful and more lucrative job opportunities for younger workers, further deepening the pool of potential entrepreneurs. This potential multiplicative effect provides an especially strong motivation to address student debt and delayed work opportunities for younger Americans.

Other policy tools also exist that could spark a resurgence in business creation rates. First among those is the creation of a visa for immigrant entrepreneurs that allows foreign job-creators to start and operate businesses in America. Researchers agree that immigrants are more likely to found businesses than natives, and that these businesses generate more innovations than the average native-founded business. This tendency toward innovation is borne out especially in the high-tech sector, where estimates indicate that up to 25% of firms are founded by immigrants.¹² Yet, despite immigrants' propensity for high-impact entrepreneurship, U.S. law provides no dedicated means for immigrants to

⁹ Brent W. Ambrose, Larry Cordell, and Shuwei Ma, "The Impact of Student Loan Debt on Small Business Formation," Working Paper, March 29, 2014, at <http://ssrn.com/abstract=2417676>

¹⁰ Heidi Shierholz, Alyssa Davis, and Will Kimball, "The Class of 2014: The Weak Economy Is Idling Too Many Young Graduates," *Economic Policy Institute*, May 1, 2014, at <http://www.epi.org/publication/class-of-2014/>

¹¹ Paige Ouimet and Rebecca Zarutskie, "Who Works for Startups? The Relation Between Firm Age, Employee Age, and Growth," Finance and Economics Discussion Series, Divisions of Research and Statistics and Monetary Affairs, Federal Reserve Board, 2013, at <http://www.federalreserve.gov/pubs/feds/2013/201375/201375pap.pdf>

¹² Sari Kerr and Nachiket Bhawe, "Immigration in Entrepreneurship," *State of the Field*, September 5, 2014, at <http://sotf.kauffman.org/>

launch innovative companies in the United States. The creation of a startup visa would have an immediate impact on business creation and growth.

Congress should also examine the role regulatory accumulation may play in depressing entrepreneurial activity. As new regulations are enacted on top of existing rules, businesses are faced with the challenge of navigating an increasingly complex regulatory regime. A handful of ideas have been proposed to address this challenge, including the establishment of a Regulatory Improvement Commission¹³ and the automatic sunset of major rules after a set amount of time.¹⁴ More broadly, attention should be given to rent-seeking behavior by incumbent firms, prominently exemplified by their pursuit of superfluous licensing regulations that can unnecessarily reduce competition.¹⁵

Finally, good policy decisions depend on good information. Congress can support the development of good public policy by ensuring statistical agencies, like the U.S. Census Bureau, receive sufficient funding to collect timely and relevant data on entrepreneurship. The Census Bureau's Business Dynamics Statistics has been paramount in illuminating the economic importance of young firms and especially their role in job creation. This valuable data collection effort is deserving of continued support.

Another critical vehicle for gaining insights into entrepreneurship is the Survey of Business Owners (SBO) conducted by the Census Bureau. The Kauffman Foundation and the Census Bureau are partnering on a pilot project to expand and annualize the SBO, which has been collected every five years. This public-private partnership will collect information on business activities during calendar year 2014 to 2016. After that time, we hope the increased value of the annualized survey will be recognized by Congress and supported through annual appropriations.

The declining business creation rate is deserving of policymakers' attention because of new and young firms' disproportionate role in job creation and

¹³ Michael Mandel and Diana G. Carew, "Regulatory Improvement Commission: A Politically-Viable Approach to U.S. Regulatory Reform," *Progressive Policy Institute*, May 2013, at http://www.progressivepolicy.org/wp-content/uploads/2013/05/05.2013-Mandel-Carew_Regulatory-Improvement-Commission_A-Politically-Viable-Approach-to-US-Regulatory-Reform.pdf

¹⁴ "The Startup Act of 2011," Kauffman Foundation, 2011, at http://www.kauffman.org/~media/kauffman_org/archive/newsrelease/2011/8/startup_act.pdf

¹⁵ Dane Stangler, "Occupational Licensing: How A New Guild Mentality Thwarts Innovation," *Progressive Policy Institute*, March 2012, at http://progressivepolicy.org/wp-content/uploads/2012/04/03.2012-Stangler_Occupational-Licensing_How-A-New-Guild-Mentality-Thwarts-Innovation1.pdf



innovation. The Kauffman Foundation continues to explore reasons for this decline and ways in which it might be mitigated and reversed. In early 2016 we plan to unveil a New Entrepreneurial Growth Agenda, which will identify ways the United States can attain a new, faster-growing, and more broad-based entrepreneurial economy.

While there are reasons to be optimistic about the future, business creation rates are unlikely to rebound without the support of good public policy.

Thank you, again, for the opportunity to testify.