Entrepreneurship and the Economic Crisis

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Session Chair
Important Questions

• Who creates jobs?
  – Small vs. large
  – Young vs. old
  – Debt vs. equity financed
  – Cities vs. suburbs, etc, etc

• What jobs?
  – Quality
  – Durability

• Has the financial crisis and recession impacted the “who” and “what”? 
Paper topics/summaries

• Business creation
  – Firm level (Cross-country)
  – Entry rate positively related to country’s income and use of credit
• Business creation
  – Individual level (U.S.)
  – Local unemployment is an important predictor, especially for unemployed workers
• Capital structure of young (2004 vintage) firms
  – Firm level (U.S.)
  – Choice of initial capital structure is difficult to predict, but there is convergence toward common structure over time
IMPACT OF THE FINANCIAL CRISIS ON NEW FIRM CREATION
Business creation is correlated with income and credit

Income and credit are also positively correlated
Creation rates have slowed since 2006

New firms (corporations) as % of population
Comments

• Data limitation narrows definition of new businesses to corporations (excludes partnerships, sole proprietors)
  – Fairlie (2010) using a broader definition of business, finds an increase in business creation in U.S. during recessions

• The regression analysis doesn’t add much to the charts
  – Pre-crisis trend in entry density was stronger in higher income countries, and then slowed relative to trend
  – Fit seems too good to have really isolated “economic effects”
THE GREAT RECESSION AND ENTREPRENEURSHIP
Definition: Entrepreneurship Rate

- % of pop. that start a business each month
  - Answer yes to the question: “Do you have a business or a farm”? But did not have a business or farm last survey
  - The business is their main job, and at least 15 hrs/wk

- CPS advantages
  - relatively detailed information on business owner
  - covers all forms of businesses (incorporated/unincorporated/employer/non-employer businesses)

- CPS disadvantages
  - no information on business performance
Measurement issues

• Entrepreneurship
  – Does not capture business owners who changed from nonbusiness owners to business owners with < 15 hrs/wk.
  – Treats those moving from <15 to > 15 hrs/wk as a new business
  – Reconciling with other measures of business creation?

• Home equity
  – Is local average home prices a good proxy for an individual’s home equity?
  – Linking with other micro-data sources?
Declines in self-employment and establishment births
Entrepreneurs of Necessity?

Figure 9: Actual and Predicted MSA Entrepreneurship Rates from Local Unemployment Trends
Education

Kauffman Index of Entrepreneurial Activity by Education (1996–2009)

Unemployment Gap: Less than HS vs. College Degree

Source: Haver Analytics
Industry/Occupation


Unemployment Gap: Construction vs. Total

Source: Haver Analytics
• The unemployed have higher business creation rates than employed workers
THE DISTRIBUTION AND EVOLUTION OF THE CAPITAL STRUCTURE OF ENTREPRENEURIAL FIRMS
Evolution of Capital Structure

Book Leverage
(Debt share of total financing)

- LOW
- MED
- HIGH

Year:
- 2004
- 2005
- 2006
- 2007
- 2008
Comments

• Robb and Robinson (2010):
  – On average, startups rely on formal credit market access even at their earliest stages of life.
  – On average, debt continues to be a primary source of funding throughout the first four years of the firm's life.

• This paper:
  – Finds initial state-dependence, and convergence of capital structures over time
  – can’t explain the initial capital structure choice
  – can’t find a large 2007/08 effect on convergence

• Is capital structure of non-survivors different?
Start-up firms do not appear to be affected in the long term if they start in a recession, unless that recession is prolonged.

– One implication is that cohorts that started right before or at the start of the 2007–09 recession may have worse outcomes relative to firms starting more recently.

– After Inception: How Enduring is Job Creation by Start-ups? Michael Horrell and Robert Litan, Ewing Marion Kauffman Foundation, July 2010
Entrepreneurship and the Economic Crisis
CPS: Self-employment measures

“Last week, were you employed by government, by a private company, a nonprofit organization, or were you self-employed (owned a business)?”

Construction: self-employment rate 18% (unincorporated) v.s 9% (incorporated)
Self-employed with employees

Chart 4. Proportion of the unincorporated self-employed with paid employees, 2000–2009 annual averages
Gender

Kauffman Index of Entrepreneurial Activity by Gender (1996–2009)

Source: Robert W. Fairlie, University of California, Santa Cruz, using the Current Population Survey.

Unemployment Gap: Males vs. Females

Source: Haver Analytics
Race

Kauffman Index of Entrepreneurial Activity by Race
(1996–2009)

Sources: Robert W. Fairlie, University of California, Santa Cruz, using the Current Population Survey.

Unemployment Rate: Hispanic (SA, %)
Unemployment Rate: Black (SA, %)
Unemployment Rate: White (SA, %)

Sources: Bureau of Labor Statistics/Haver Analytics
Age

Kauffman Index of Entrepreneurial Activity by Age (1996–2009)

Unemployment Gap: Over 55 vs. Total