



Community and Economic Development in North Carolina and Beyond Blog: Which Types of Businesses Drive Job Creation?

By Jonathan Morgan

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Jonathan Morgan is a School of Government faculty member.

A widely cited statistic that is generally accepted at face value is that anywhere from 60 to 80 percent of new jobs are created by small and/or existing firms. What is the basis for this information? Is this a well-established fact or merely a factoid? This statistic is based largely on some pivotal research published by economist David Birch in the 1980s. Birch analyzed a sample of 5.6 million business establishments compiled from Dun & Bradstreet data files for the period 1969 to 1976 and found that firms with 20 or fewer employees created two-thirds of all net new jobs and firms with 100 or fewer employees created about 80 percent of net new jobs.[i] In 1994, Birch co-authored a book chapter that used an animal metaphor to characterize different types of firms and their likely contribution to job creation.[ii] Using this metaphor, the “gazelles” are the young start-up firms that grow rapidly and add substantial numbers of jobs. By contrast, the “elephants” are the large, established businesses that do not experience much increase in net employment and the “mice” create jobs when they start up but tend to stay relatively small. Birch’s findings are often used to demonstrate the potential of economic development strategies that focus on retaining and growing existing small businesses and supporting entrepreneurship. The contemporary thinking is that those strategies are more effective approaches to economic development than traditional industrial recruitment due to the “fact” that they account for the lion’s share of new job creation.[iii]

Some recent studies using new data sources bolster Birch’s primary finding that small firms create the most jobs, but others provide a more nuanced view. In July 2010, the Kauffman Foundation released a report that boldly asserts: “startups aren’t everything when it comes to job growth. They’re the only thing”.[iv] The Kauffman study analyzes a new dataset called Business Dynamic Statistics compiled by the U.S. Census Bureau, which tracks annual startups and new business locations from 1977 to 2005. A major finding of the Kauffman study is that start-up firms (those younger than one year old) create an average of 3 million jobs annually, while existing firms lose 1 million jobs net each year. That existing firms are found to be “net job destroyers” leads the study author to conclude that the focus of economic development policy interventions is often “misplaced” given that “job growth is driven, essentially entirely, by startup firms that develop organically”.[v] The author notes an important caveat in this research on the role of startups and existing firms in job creation: that although existing firms tend to be net jobs losers, once firm deaths are taken into account, surviving existing firms, particularly gazelles, will likely create more net jobs than startups do. A 2007 report published by the Federal Reserve Bank of Kansas City uses the U.S. Census Bureau’s Statistics of U.S. Business to demonstrate that small firms (those with less than 20 employees) created 79.5 percent of all net new jobs from 1990 to 2003.[vi] However, the report points out that “the relatively high share of net new jobs created by small businesses stems mainly from relatively large gross job losses among larger firms—not from massive job creation by small firms”.[vii] Among small businesses the report found that both gross and net new jobs are fueled by expansions of existing businesses much more so than new business startups. The study also found that the quality of the jobs at large businesses is higher in terms of pay, fringe benefits, and job stability. Despite the lower job quality at small businesses, the report advises that “concentrating on organic growth, or the growth of existing or ‘home-grown’ businesses, is likely to be a much more successful strategy than the recruitment of new firms” and “supporting entrepreneurs and budding businesses is also likely to be an effective strategy”.[viii]

In one of the more direct critiques of Birch’s work and its applications to economic development policy, a 2009 article published in the *Economic Development Journal* challenges the current thinking about the role of small businesses in job creation.[ix] The article reports the findings from various analyses of longitudinal data made available by the U.S. Small Business Administration (SBA) Office of Advocacy. Among its findings are:



- 1) A small business strategy will not generate substantial net new jobs;
- 2) Business expansions accounted for two-thirds of job growth from 2001-2005, while start-ups and branch facility locations each account for about a fifth of total job growth during that period;
- 3) Large firms with 500 or more employees generated more gross jobs than small firms;
- 4) Startup firms create significant numbers of gross jobs but the net numbers are drastically diminished by high business failure rates;
- 5) In the current economy, Birch's high impact gazelles are not likely to be small firms or startups;
- 6) Startup businesses tend to be in sectors that serve local markets (food service, construction, retail) and will not generate as much economic impact and wealth as firms operating in primary, export sectors; and
- 7) New branch facility locations and business expansions drive job growth in primary, export sectors to a much greater extent than do startups.

The article concludes that "branch recruitment in the primary sector is a more productive strategy than startups and even rivals business expansions in the generation of net new jobs".[x]

How do we reconcile the different findings about which types of firms are most important for job creation? One issue, for sure, is the variation in data sources and time periods across studies. This intriguing line of inquiry is an important one that needs to continue in order to provide greater clarity for policymakers and economic development practitioners.

[i] David Birch, "Who Creates Jobs?", *The Public Interest* 65, 1981, p. 7.
http://www.nationalaffairs.com/public_interest/detail/who-creates-jobs

[ii] David Birch and James Medoff., J., 1994, Gazelles, in Solmon, L.C. & Levenson, A.R. (eds.), *Labor Markets, Employment Policy and Job Creation*, Boulder: Westview Press.

[iii] For example see Henry M. Cothran, "Business Retention and Expansion (BRE) Programs: Why Existing Business are Important" (University of Florida, IFAS Extension, 2009), available at <http://edis.ifas.ufl.edu/pdf/FE/FE65100.pdf>

[iv] Tim Kane, The Importance of Startups in Job Creation and Job Destruction, Ewing Marion Kauffman Foundation, July 2010. http://www.kauffman.org/uploadedFiles/firm_formation_importance_of_startups.pdf

[v] Ibid, p. 6.

[vi] Kelly Edmiston, "The Role of Small and Large Businesses in Economic Development", *Economic Review*, 2nd Quarter, 2007, Federal Reserve Bank of Kansas City. <http://www.kansascityfed.org/publicat/econrev/pdf/2q07edmi.pdf>

[vii] Ibid, p. 78.

[viii] Ibid, p. 91

[ix] Ed Bee, "Coming Full Circle: The End of the Small Business Era?", *Economic Development Journal*, vol. 8, no. 1, 2009. <http://www.towson.edu/outreach/ueda/newsletter/Coming%20Full%20Circle.pdf>

[x] Ibid, p. 12.