

Discussion of
“The Local Origins of Business Formation”

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This Paper

- Document the spatial variation in “startups per capita”
- “Startups per capita” is comprised of “idea generation” and the “transition of idea into a startup”
- Measurement:
 - Idea generation: *EIN registrations (per-capita)*
 - Conversion of ideas into startups: *The share of those with EINs that transition to eventually employing workers (two years after EIN registration)*
- Paper documents spatial variation in those two measures and then correlates the local measures with local demographics and socioeconomic conditions.

My Comments

- Take a step back and think about the nature of small business formation.
- John Haltiwanger and I have been exploring two sides of the same coin for the last few decades.
 - Me: *Essentially no small business grows*
 - John: *Most growth comes from small business entry*
- Both statements are true.....the growth distribution of small business entrants is highly skewed!! (“Gazelles”)
- Huge heterogeneity in the types of small business created – *need to be careful when using small business formation as a measure of "idea" generation.*

Description of Small Businesses in U.S. Economy

- *Draw on my work with Ben Pugsley: “What Do Small Businesses Do?” and “Wealth, Tastes, and Entrepreneurial Choice”*
- For what comes on next few slides....:
 - Define small business owners as those with less than 20 employees (all have EINs).
 - Use data from the 2003-2007 Statistics of U.S. Businesses (SUSB) – compiled by the U.S. Census.
 - Group all small businesses (across all industries) into 4-digit NAICS industries (there are about 300 4-digit NAICS codes).
 - Define: x_j is share of small business in industry j out of all small businesses.

Small Businesses (< 20 Emps) by 4 digit Industry

Full-Service Restaurants (7221)	4.0	Accounting Services (5412)	1.6
Offices of Physicians (6211)	3.7	Personal Care Services (8121)	1.5
Limited Service Restaurants (7222)	3.5	Consulting Services (5416)	1.4
Religious Organizations (8131)	3.5	Gas Stations (4471)	1.3
Build. Equip Contractors (2382)	3.3	Child Day Care Services (6244)	1.3
Dentists (6212)	3.1	Lessors of Real Estate (5311)	1.2
Auto Repair (8111)	2.6	Other Professional Serv. (5419)	1.2
Legal Services (5411)	2.6	Computer System Design (5415)	1.2
Res. Bldg Construction (2361)	2.5	Other Specialty Contractors (2389)	1.1
Service to Build. (5617)	2.5	Business/Political Orgs (8139)	1.1
Build. Finishing Contractors (2383)	1.9	Grocery Stores (4451)	1.1
Build. Exterior Contractors (2381)	1.9	Other Recreation Industries (7139)	1.0
Insurance Agents (5242)	1.8	Building Material Dealers (4441)	1.0
Other Health Practitioners (6213)	1.7	Pharmacies (4461)	0.9
Arch./Engineering Services (5413)	1.6	Real Estate Agents/Brokers (5312)	0.9
Sum of Top 15	~40%	Summary of Top 30	~60%

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Fact 1: Heterogeneity Across Industries in Small Businesses

- The bulk of “startups” analyzed in the paper are not future Googles or Apples.
- Most small business startups are more akin to occupational choice:
 - *restaurants,*
 - *local parishes,*
 - *skilled craft (plumbers, electricians, painters),*
 - *small retail (gas stations, liquor stores, grocery stores),*
 - *professional services (doctors, accountants, real estate agents)*
- **Many are human capital intensive that are hard to scale or are small scale local services.**

Two Other Data Sources Ben and I Used

- *Kaufman Firm Survey (KFS)*
- *Panel Study of Entrepreneurial Dynamics (PSED)*
- Both surveys follow a group of people who state that they plan to start a business but have not yet started a business.
- Use the surveys to:
 - Explore motivations for small business formation
 - Trace out the lifecycle of nascent “entrepreneurs” (i.e., people who start small businesses)

Fact 2: Most Small Businesses That Start Never Add More Than A Few Employees (Focus on Survivors): Data from KFS

	Percent Changing Employment Over Last 4 Years		
	Percent With Δ Employment > 0 Employee	Percent With Δ Employment > 5 Employees	Percent With Δ Employment > 10 Employees
All New Firms	41.9	10.8	3.6
Sample Size	2,617	2,617	2,617

- **This paper: ~12% of all EIN's eventually have an employee two years out
~35% of EIN's that say that they want employees actually hire workers within two years**

Fact 3: Most Small Businesses Report Wanting to Stay Small

Data: Panel Study of Entrepreneurial Dynamics

	All PSED Respondents
<hr/>	
<i>Percent of New Firms That Report That They Want to Be “Big” *</i>	<i>24.3</i>
Expected Number of Employees Working in Firm When it is 5 Years Old (p25)	1
Expected Number of Employees Working in Firm When it is 5 Years Old (Median)	4
Expected Number of Employees Working in Firm When it is 5 Years Old (p75)	10

The PSED question reads: “Which of the following two statements best describe your preference for the future size of this new business: I want this new business to be as large as possible, or I want a size I can manage myself or with a few key employees?”

Fact 4: Most Small Businesses Never Report Innovating

Data From the Panel Study of Entrepreneurial Dynamics

	Sample: Positive Revenues Two Years Out
Percent of Firms that Already Developed Proprietary Technology, Processes, or Procedures (ex-post measure)	8.3
Percent of Firms that Already Applied for Patent, Copyright, or Trademark (ex-post measure)	6.0
Percent of Firms Stating That Many Existing Firms Already Offer Same Product/Service to Expected Customer Base (ex-ante measure)	43.3
Percent of Firms Stating That No Existing Firms Offers Same Product/Service to Expected Customers (ex-ante measure)	13.3
Sample Size	602

Three Questions

1. What forces can explain why those who register for an EIN never employ any workers two years out?

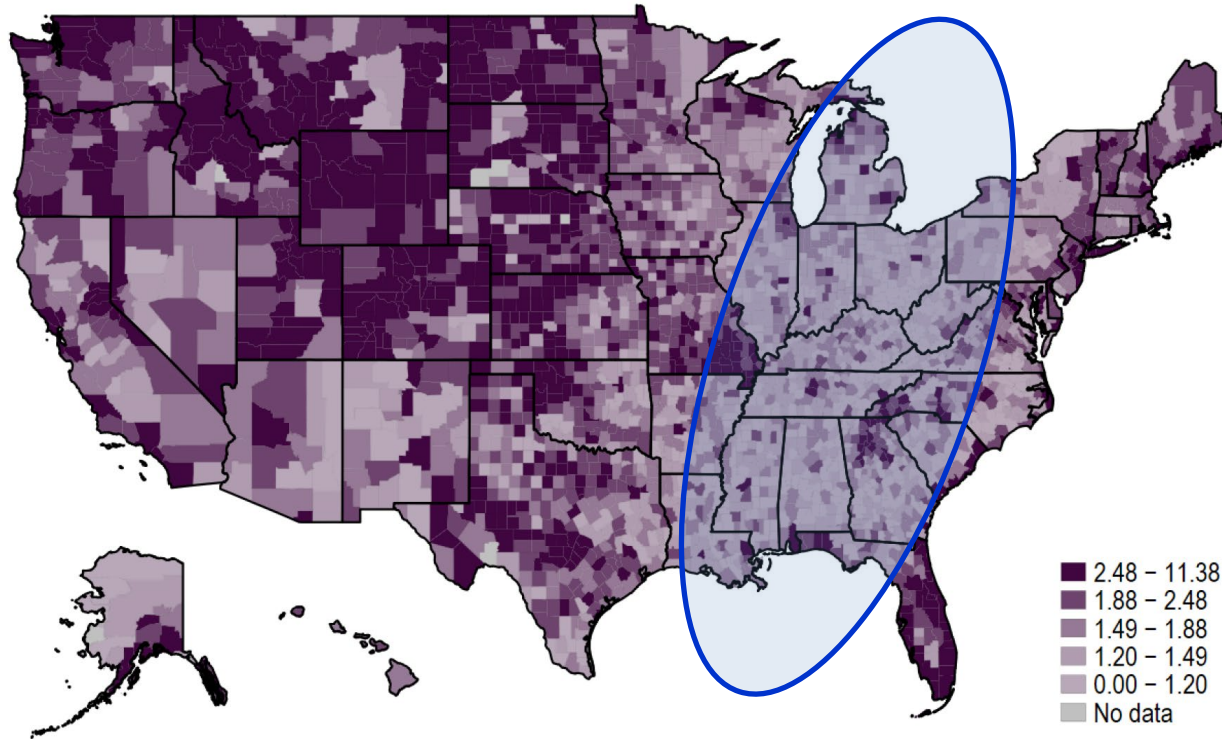
- Those with EIN never really want to start a business or hire employees (getting an EIN provides option value).
- The underlying ID is ultimately not very good.
- The industry in which an individual is starting a business has a natural small scale (like skilled craftsmen).
- There are frictions to the startup process (regulation, capital constraints, etc.)

Three Questions

2. What explains spatial variation in employer business formation?

- Different industry/occupation mix? Suppose the paper was written documenting the spatial variation in restaurants per capita or lawyers per capita?
- Places with high manufacturing share (relative to services) should have lower small business formation (as seen above more entry into services)

Figure 1 from Paper: Startups per capita, by county



No ideas where there is manufacturing?

Three Questions

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- Different industry/occupation mix? Suppose the paper was written documenting the spatial variation in restaurants per capita or lawyers per capita?
- Places with high manufacturing share (relative to services) should have lower small business formation (as seen above more entry into services)
- *Barriers? Is there any evidence of spatial variation in barriers?*
- *Spillovers/agglomeration? Is there any direct evidence of spillovers?*

Three Questions

3. What are you hoping to learn about spatial variation in doctors, plumbers, restaurants?

- Implicit assumption throughout the paper is that the startups are linked to dynamism
- But, almost all of these firms will never grow – they are service sector business with small natural scale.
- Back to the discussion that John and I have been having for decades. Most small business do not grow (even though a small few are important for aggregate growth).
- If interested in dynamism, why not look at spatial variation in business that receive VC funding (or something more directly tied to the Gazelles?)

Concluding Thoughts

- Really interesting paper on a very important topic! Lots of great data work!
- Question 1: How do we think about the heterogeneity in small businesses? Is the goal to think about the spatial variation in restaurants, plumbers, dry cleaners, and dentists?
- Question 2: If goal is to think about “start ups” that are closer to our model of potential Gazelles – why not look at other measures that are a closer match to the idea that startups are an engine of new ideas and growth?