High Growth and Failure of Young Firms

Newly released data from the U.S. Census Bureau, the Business Dynamics Statistics (BDS)[1], allow unprecedented tracking of business dynamics for U.S. firms and establishments. This is the fourth in a series of briefings to highlight some key features of the data.

What is the role of young entrepreneurial firms in job creation? Until now, researchers lacked comprehensive data broken out by firm age necessary for understanding this fundamental dynamic in our economy. A novel feature of the BDS is that employment growth and market selection can be tracked by firm age for the universe of U.S. private, non-agricultural businesses.

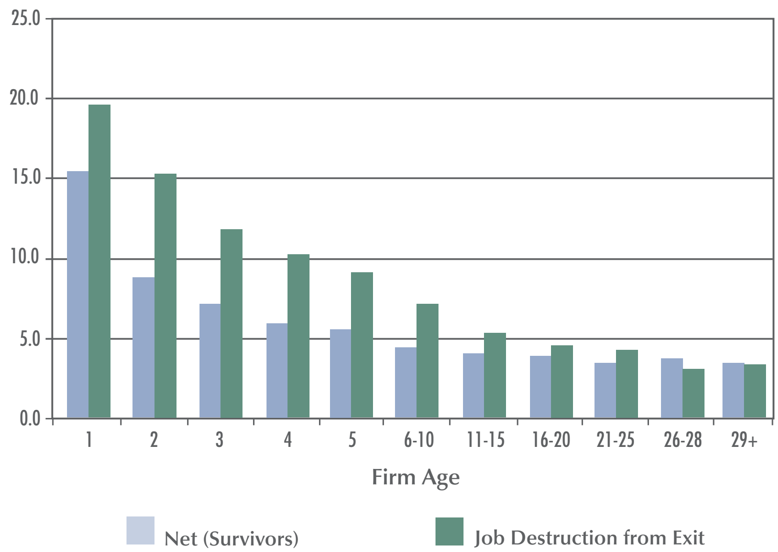
Figure 1 shows the relationship between firm age, and both the net employment growth rate for continuing establishments and the job destruction rate from establishment exits.[2] Omitted from the chart are establishments of new startup firms who, by definition, only contribute to job creation. Startups account for about 3 percent of the stock of all jobs.

The chart shows that young firms have higher employment growth rates, if they survive, than older firms. For example, establishments belonging to very young firms (age 1) have a net employment growth rate of about 15 percent conditional on survival, whereas those belonging to older firms (age 29+) have a net employment growth rate of about 4 percent conditional on survival. However, younger firms experience much more employment loss due to establishment exit, nearly 20 percent at very young firms, than do larger firms.

The pattern for young firms is thus one of "up or out" with very rapid net growth for survivors balanced by a very high exit rate. This pattern highlights the importance of developing richer measures of business dynamics, such as those in the BDS. Understanding U.S. business dynamics requires not only statistics by business size and age, but measures of the variability of business outcomes, as well. Lumping together all firms of the same age is clearly misleading, given this "up or out" dynamic. Young firms obviously are doing both better and worse than more mature firms in terms of growth and survival.

This briefing highlights only one dimension of the Census Bureau's new Business Dynamics Statistics. The BDS includes measures of business startups, establishment openings and closings, and establishment expansions and contractions in terms of both the number of establishments and the number of jobs. The BDS data provide these new statistics for the 1977-2005 period on an annual basis with classifications for the total U.S. private sector, by broad industrial sector, by firm size, by firm age, and by state. Further information about the BDS can be found at: http://www.ces.census.gov/index.php/bds/bds_home

Figure 1
Employment Dynamics by Firm Age, 1987-2005



Note: Establishments are classified by the age of the parent firm.

1. 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.

2. These rates are computed with total employment as the denominator. Detailed definitions are available at http://www.ces.census.gov/index.php/bds/bds_overview#_Concepts_and_Methodology