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The Great Recession and the Startup Slowdown

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- The Great Recession caused an unprecedented downturn in employer startups.
- The "startup slowdown" shifts job generation away from dynamic, young businesses, increasing the economy's reliance on existing establishments to expand.
- The downturn in startups also contributes to a decrease in economic dynamism, a crucial source of market information for future entrepreneurs.

In our last report, we saw that nonemployer establishments, including "gig" workers, have grown steadily in number over the past two decades, while growth in employer establishments has been inconsistent. In particular, the Great Recession of 2007-2009 appears to have had a dramatic negative effect on net establishment growth. Here, we expand our analysis to look separately at openings and closures. All figures discussed here refer to employer establishments – businesses or business locations with at least one employee in addition to the owner.

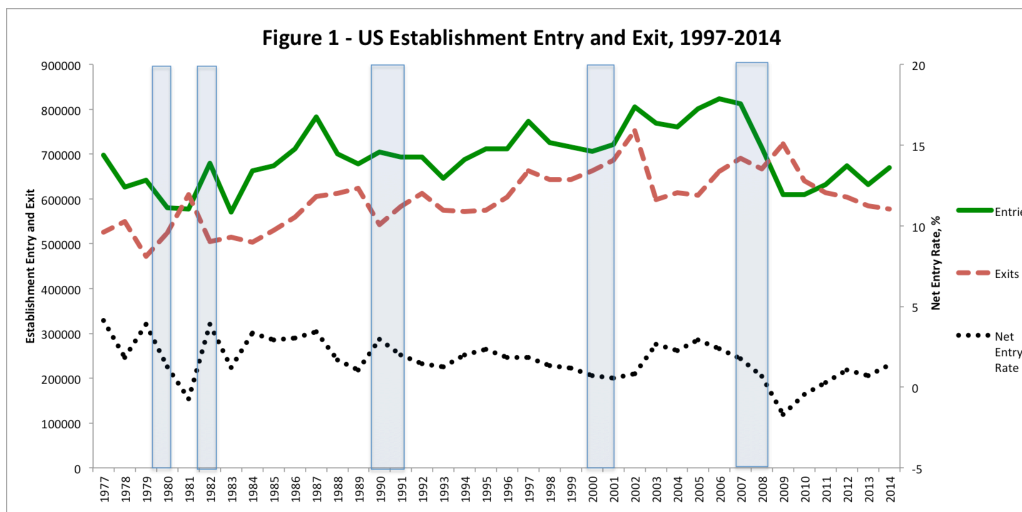

Figure 1 - US Establishment Entry and Exit, 1997-2014

Figure 1 shows annual establishment openings and closures, and net entry rate in the US during a time period spanning five recessions, which are shaded. Note the magnitude of entry and exit on the left scale: more than half a million businesses open and another half million close every year in the US over this time, meaning a third to a fifth of all establishments turn over annually.

Recessions always cause an uptick in closings. But surprisingly, openings don't tend to fall during recessions; in some cases they even increase, offsetting the higher rate of closures. The one exception is the Great Recession: startups fell precipitously from 2007 to 2009, and remain lower than any time in the past 20 years. As a result, closures exceeded openings in 2009 for the first time in decades. This is what makes the Great Recession different: other recent recessions cause peaks in closures, but none has brought such a long-lasting decline in startup activity.

Overall, Colorado tracks closely with national averages. By some measures, the Great Recession had less impact on Colorado than the US as a whole. But the Tech-Telecom-Tourism recession of 2001 hit Colorado harder, due to its concentration in precisely those industries. Consequently, closings in the state spiked at a rate 50% higher than the national average in 2001 and 2002.

Why does the Great Recession's impact on startup activity matter? For one, the rate of new openings tells us about business confidence. John Maynard Keynes famously wrote that firms expand or contract their productive capacities based largely on "animal spirits," subjective expectations about future demand. The stark decrease in openings in 2007-2009 paints a picture of gloomy animal spirits. Although the official recession is over, its impact lingers in the form of more pessimistic expectations.

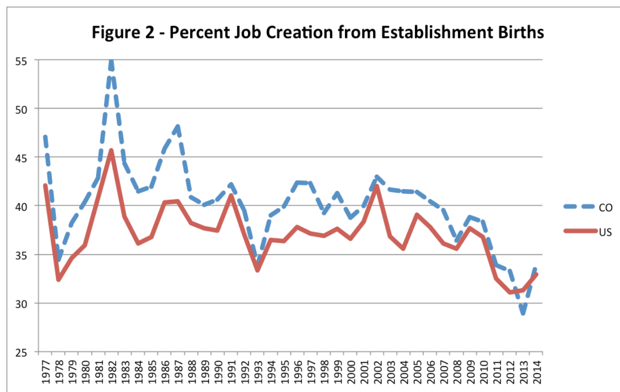

Figure 2 - Percent Job Creation from Establishment Births

More tangibly, startups are a major source of job creation. Figure 2 shows that the proportion of jobs created by establishment entry has been in decline since the early 2000's in the US and Colorado, and has fallen more steeply since the Great Recession. If this trend continues, the Colorado and US economies will become increasingly reliant on job creation from within pre-existing businesses, which are by their nature less dynamic and innovative job creators.

Lastly, as seen in Figure 3, turnover - openings and closings in a year as a percent of all establishments in operation - has fallen nationally and in Colorado since the 1980s, and more rapidly since the recessions of 2001 and 2008. This decline is significant: in the 1970s, one in three establishments turned over annually – that's 1.2 million businesses across the US. Today, one in five turn over in a year.

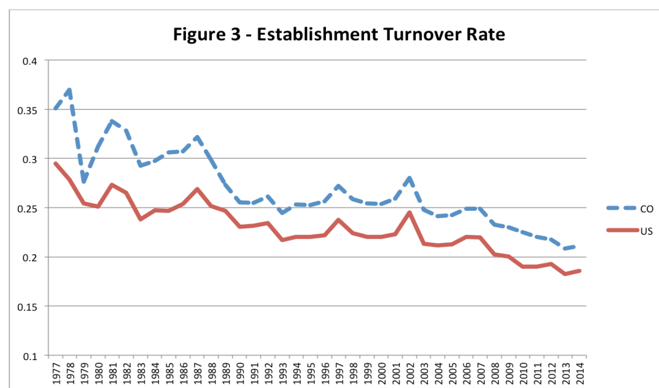

Figure 3 - Establishment Turnover Rate

In keeping with its reputation as a dynamic economy, Colorado has consistently experienced above-average turnover rates.

In addition to the role of startups in creating jobs, turnover itself is crucial to economic dynamism. Each new business venture represents some small economic innovation, whether in product, process, service, geography, market niche, or otherwise. In that sense, each entrepreneurial project – successful or unsuccessful – is one tiny but important step in pushing the innovative frontier, which is crucial to generating sustainable economic growth. Every entry and exit provides information to other potential enterprises about what does and doesn't work in a particular market. The post-Great-Recession decline in business dynamism could mean potential entrepreneurial ventures now have less information on which to base their plans, making an already-risky startup that much more tenuous.

We know, however, that nonemployers have fared relatively well in the past decade. This suggests that the Great Recession has not so much dampened entrepreneurial spirit as it has stifled employer startups, perhaps due to decreased access to credit. A forthcoming report looks at the sectors in which "gig" work has grown the fastest to see what industries exhibit the most entrepreneurial potential in the face of this startup slowdown.