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The employment effects of new businesses – a survey of the current state of research

Policy as well as public opinion apparently take for granted that start-ups of new businesses lead to rising employment. Recent empirical research has, however, shown that the development of the new businesses represents only a small part of the effects. There are several indirect effects of new businesses which are rather important for their overall impact. First, successful start-ups displace established firms, thus the new jobs are at least partly generated at the expense of others. Second, the market entry emergence of new competitors may induce improvements on the side of the incumbents leading to higher competitiveness of the economy even if the start-ups should not be able to survive for a longer period of time. A basic precondition for the occurrence of these supply-side improvements is that competition between the new and the established suppliers works according to a “survival of the fittest” scenario and that market selection is not distorted by public subsidies to new businesses.

Studies for several countries have altogether shown that the employment effects of new businesses need a period of up to ten years to unfold. There are pronounced regional differences in the scope of these effects. In general, new business formation affects job growth positively. However, the main positive effects take about five to six years to become visible. In certain cases, the effect of new business formation on economic development can even be negative. One major factor determining the size of the effect is obviously the quality of the start-ups. The quality of the start-ups may be related to such factors as the entrepreneurial qualification of the founder(s), elaborated concepts, the knowledge base of the new firm, the amount and the quality of resources mobilized as well as the innovativeness of the supplied goods and services.

A main conclusion for growth policy is that stimulating start-ups can obviously not be recommended for all regions and under all circumstances as a reasonable strategy. A policy that tries to promote new business formation should particularly try to avoid any distortion of competition between the entrants and the incumbents. For this reason, all measures that support start-ups after they have entered the market are questionable. Policy should rather try to improve the entrepreneurial competencies and the attitude towards founding a business (enabling policy), i.e., stimulating entrepreneurial spirit, provide advice for nascent entrepreneurs, lower administrative hurdles, etc. Since not all types of start-ups have a significant effect on economic growth, it could be sensible to focus measures for promoting new business formation on certain kinds of start-ups.