



Policy Brief on Job creation by new starters

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Abstract

confusion between size and age. It is not small but young companies that play a crucial role in creating of new employment. And among those young firms, it is especially those that already in the first years after starting have a significant size, that survive and ensure permanent job creation. Our analysis is based on new business data and represents the growth and age of all Belgian companies correctly. Since 2009 we have been work together with the Rijksdienst voor Social Security and Statistics Belgium at the construction of this data.

Small is beautiful?

Small businesses are an attractive population for interest groups and policy makers: there are many of them and they face all kinds of obstacles. Numerous support measures such as growth premiums, VAT exemptions and contribution reductions for first hires help them to survive and grow. It supposedly allows small businesses to play an important role in the creation of employment. But is this correct? Which evidence supports the crucial importance of small businesses for job creation? In our recent research, we show that this is a stubborn misconception, based on two mistakes (Geurts & Van Biesebroeck, 2014).

First, it is not so much the small companies, but the young companies that create additional jobs. Because young companies are predominantly small, it looks like small businesses grow strongly on average. However, as soon as one controls appropriately for age, it turns out to be only young companies have high growth ratios, while employment in older small businesses shrinks year-on-year. Haltiwanger, Jarmin and Miranda (2013) have convincingly demonstrated this for the United States. Especially in a dynamic economy with a high degree of creative destruction do we find



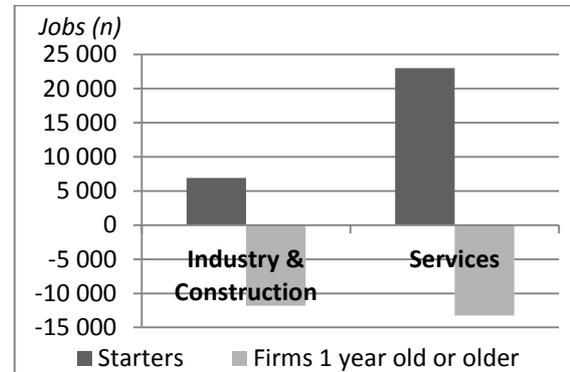


many young companies in the small size classes. We find the same pattern for Belgium.

Second, official databases are primarily used to produce economic statistics. However, such databases have been set up for administrative purposes and tend to give an incorrect picture of the dynamics of companies. The biggest mistake is in the identification of starters and shutdowns. Many successful companies split in multiple parts, they merge or change company number. In short, they disappear from the database and pop up with a new identification number. This leads to a huge overestimation of starters and shutdowns and to a gross underestimation of the growth of successful companies. An example of these are the statistics on bankruptcies and associated job loss that we read monthly in the newspaper and that are produced by a commercial data provider. They have only a very misleading relationship with the actual situation.

Thanks to a new methodology, which we describe below, we can identify real starters and follow their growth path in their first years. These de novo starters are new entrants to the market that effectively develop new economic activities and recruit new employees for this. If we correctly identify starters in the private sector, we find that they have about 30,000 jobs each year, or 1.5% of total private employment. This is only half of some common statistics based on official databases. Cumulatively, this means the share over the years of young companies in total employment is much smaller than previously assumed. Moreover, we find among young companies a strong positive relationship between growth and size. Businesses that soon after startup reach a certain size, are less likely to fail and exhibit higher growth rates.

Figure 1: Yearly job creation in the Belgian private sector (2003-2012)



Starters maintain aggregate employment

The private sector in Belgium has more than two million jobs and grew by 2% between 2003 and 2012. An average of 5,000 jobs were added per year, but this modest net growth hides a huge amount turbulence of companies that grow, shrink, start or stop their activities. An important role in this dynamic is reserved for starters. Figure 1 shows that the number of jobs at existing companies – companies of at least one year old – shrinks year-on-year. Both in industry and construction, as well as in the services sector, job creation by starters ensures that net growth is still positive. In part, starters are eliminating jobs at existing companies. But they also innovate and thus contribute to competitiveness of our economy. This process is known as creative destruction.

Old companies in a new disguise

Starters are smaller and create fewer jobs than it is usually calculated. We explain why.

Since 2002, Belgium has a unique company number. Each new company gets a KBO number at registration and keeps it as long as it exists. All official bodies and commercial





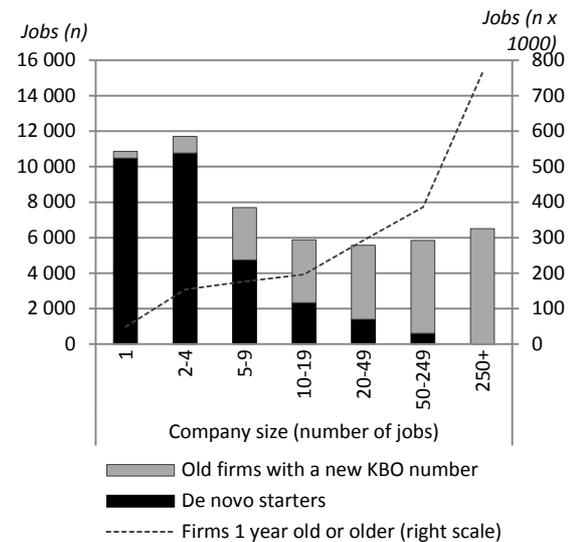
data producers use this number to identify companies. It seems like an ideal way to follow companies from start to stop, but in practice this is not so easy. Businesses can split, merge or be taken over. Other companies go into voluntary liquidation for tax or other reasons and put their activities into a new company. Here KBO numbers are deleted and new ones registered. This artificially inflates statistics about starters and stops, and hence also the number of jobs created and destroyed.

With our new methodology we are able to follow those that restructure or change company number (Geurts & Vets, 2013). The data-linking method was developed following the example of Canada, the United States and the Scandinavian countries. Together with the NSSO We looked at the workforce of companies: when a large group of employees between two quarters shifts from one to the another KBO number, we can link both numbers to the same company. The results were supplemented with that of the official data linking Statistics Belgium method, under which more external information about restructuring from the Trade Register is used to link companies.

Figure 2 shows the importance of correct identification for starters. The bars show the number jobs for new KBO numbers spread over seven size classes for an average year. Nearly 16 000 jobs per year appear at companies which start with more than twenty employees and 6,500 jobs even at companies that immediately employ 250 employees. This seems unlikely. The color of the bars indicates that this is also not correct. In black we show the jobs from real de novo starters, which we have identified with our methodology. In gray it shows existing companies that continue their activities under a new KBO number. The employment of the latter group is

concentrated in the larger size classes, just like in other existing companies. De novo starters, on the other hand, are predominantly small: 92% starts with less than five jobs and larger starters are rather exceptional. If we identify starters correctly, it appears that they create 30,000 jobs each year, and not 55,000 as naive business statistics make us believe.

Figure 2: Employment at firms newly appearing in administrative data (2004-2012)



Large, young companies grow more rapidly

The erroneous classification of existing companies as starters distorts the dynamics of young companies. If we follow only the novo starters, we find a distinct dynamic: in the first years after the start, the share of withdrawals is very high, but those who survive have high growth ratios.

If young companies manage to survive, they grow much stronger than older companies. Especially in their first year, young companies expand strongly, but the growth decreases rapidly with age. Our most striking finding is the strong positive connection between size and growth: within each age cohort grow big companies stronger than smaller ones. This





positive connection is particularly pronounced in the first years after start, and then converges to about equal growth ratios in all size classes.

Growth is slight in older companies that survive
negative to stable.

If we combine these different elements, we can highlight the importance of starters for job creation summarize as follows. More than half of the starters go bankrupt in the first five years after founding and the jobs that they created go again lost. In addition, most survivors grow

barely. However, a small number is growing quickly and can reduce the job loss among the others compensate. The bigger the company, after controlling for the age, the more likely it is to show positive job growth. This last group ensures that every cohort starters a lasting contribution to the creation of new employment. Of the 30 000 jobs that starters each year creation will remain 88% five years later. This is it net result of job loss due to discontinuations and job growth among survivors.

Facts and policy

Countries with a strong research tradition such as the United States, Canada or the Scandinavian countries, have invested since the nineties in enterprise databases for research. From our analysis it may be clear that in the absence of this, the prevailing opinion about the sources of job creation is left to interest groups. Already in 2010 thirty employees of research and statistical institutions rang the alarm bell. They wrote a pamphlet with recommendations about a central data infrastructure in Belgium that would provide access to high-value enterprise data for scientific research. Our temporary cooperation with the NSSO and Statistics Belgium makes it clear that the potential for

this is present in Belgium and our knowledge to develop this is not necessary inferior to foreign countries. A policy that wants to be correctly informed, has to make the necessary investments.

Small companies represent a large voter potential and form a popular target group for policy measures, but the reality is that they do not create so many jobs. 68% of companies employs fewer than five employees, but together only represent 11% of the private employment opportunities. Their survival chances are lower than those of larger companies and if they survive they grow less strongly. This pattern is most pronounced in young companies, but applies also for older companies. A policy that promotes the creation of employment and in particular, focuses on the smallest companies misses its goal. Especially for young companies, strong competition ensures that companies with the highest growth potential and create most jobs.

Sources for further reading:

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