The failure rates of small businesses are quite high. According to the Bureau of Labor Statistics, only about half of the businesses that opened in 1994 were still operating five years later. Isn’t a universal agreement on the definition of a small business. Furthermore, the failure rates of small business are quite high. According to the Bureau of Labor Statistics, only about half of the businesses that opened in 1994 were still operating five years later. Thus, when one accounts for job destruction, small businesses appear to account for a significantly smaller share of net new jobs created in the private sector than many people might believe.

What Do Past Studies Reveal?

The importance of small businesses to job creation has been part of the economic policy narrative for some time. In 1979, then-Massachusetts Institute of Technology Professor David Birch claimed that firms with 20 or fewer employees accounted for two-thirds of all new jobs created between 1969 and 1976, firms with 100 or fewer employees accounted for 82 percent of all new jobs created. Conversely, he found that large firms (500 or more employees) accounted for only 15 percent of net job growth. Birch’s finding challenged the conventional wisdom about job creation at the time and, accordingly, had enormous influence on policymakers and researchers. Some economists soon began to challenge Birch’s findings. Using the same data as Birch, Catherine Amorim and Marjorie Odle found in 1982 that businesses with 100 or fewer employees accounted for only 39 percent of net new jobs. Several years later, Charles Brown, James Hamilton and James Medoff pointed out that 40 percent of jobs created in small businesses in 1980 no longer existed in 1986. A more up-to-date assessment of the job-creation characteristics of small businesses can be found in work published by Stephen Davis, John Haltiwanger and Scott Schuh in 1996. These authors noted that “a common confusion between net and gross job creation distorts the overall job creation picture and hides the enormous number of new jobs created by large firms and small firms that Birch originally suggested.

Business Employment Dynamics

Researchers who want to assess the claim that small businesses account for a disproportionately large number of new jobs must first confront several issues. First, what is the best data source for the hypothesis to be tested? Second, how should a small business be defined? Third, should the focus be on the gross number of business enterprises or the number of employees? The Small Business Administration says a business is small if it employs fewer than 500 people. However, it may not be wise to lump together a Silicon Valley startup with a relatively large, established manufacturer. Third, should the focus be on the gross number of business enterprises or the number of employees? The Small Business Administration says a business is small if it employs fewer than 500 people. However, it may not be wise to lump together a Silicon Valley startup with a relatively large, established manufacturer. Fourth, how should small businesses be defined? The Small Business Administration says a business is small if it employs fewer than 500 people. However, it may not be wise to lump together a Silicon Valley startup with a relatively large, established manufacturer. Fifth, should the business be defined at the level of the entire firm or at the level of a single business establishment? The business employment framework uses the following breakdown of firm size: 1-employees, 20-employees, 100-499 employees, and 500 or more employees.

Job Gains by Firm Size

The table shows average gross and net job gains at all private business establishments from the third quarter of 1992 through the first quarter of 2010. Over this roughly 18-year period, gross job gains per quarter averaged a little less than 3 million, or about 929,000 per month. Since the 2007-2009 recession, gross job gains per quarter averaged 201,932, or 67,311 per month. The two right-hand columns in the table examine net job gains. Net job gains are defined as job gains minus job losses. Three findings are apparent from the table. First, net job gains were significantly smaller than gross job gains. The net gains per quarter averaged only 155,066, or 51,697 per month. Second, the table shows that the recession dramatically reduced the rate of net job creation. Once net job losses during the recession are removed from the calculation, the number of net jobs rose to 173,000 per quarter (about 58,000 per month). Finally, and perhaps most importantly, the BEA data show that since 1992, net job creation tended to be largest among the largest firms: these firms accounted for about 38 percent of the total. The smallest firms showed the smallest percentage of net jobs created. This result does not change if we exclude the recession period.

In short, small businesses showed lower rates of gross job creation, but they also exhibited higher rates of job destruction. Looked at from this standpoint, net job creation matters more. By Kevin L. Kliesen and Julia S. Maués

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