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The Quality of Jobs Created by Entrepreneurs

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Abstract

Few dare to challenge the conventional wisdom that small business is the engine of job creation. Indeed, in the United States, the image of the small business owner left largely unfettered to create novel products and services sits on the same cultural plane as baseball and apple pie, and one would be hard-pressed to find a policymaker who would openly question the wisdom that most new jobs arise either directly or indirectly from these small businesses. This near religious belief in the small business owner as job creator yields a steady stream of policies offering tax relief to small businesses, often specifically tied to their behavior as job creators, as well as broader proposals that aim to cut the red tape that could hinder a business's ability to raise capital or to safeguard its intellectual property. Not surprisingly, these policies and their potential to improve macroeconomic outcomes become particularly salient during times of high unemployment.

Luckily, there are still those who refuse to accept this conventional wisdom. They usually point to meticulous research on job creation that shows that the large share of employment growth typically ascribed to *small* businesses more rightly belongs to *new* businesses—entrepreneurs. And, of course, while most new businesses start out small, most small businesses are not all that young. However, even astute observers are likely to miss the second flaw in the notion that policy that props up small business will necessarily improve our nation's economic health. That is, after one sorts out the issue of the *quantity* of jobs created by new businesses, one should consider the *quality* of these jobs. Are these really the sorts of jobs that will materially improve the lives of their incumbents, thereby setting off a chain reaction that ultimately ends in higher aggregate demand and greater economic activity?

Keywords

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Few dare to challenge the conventional wisdom that small business is the engine of job creation. Indeed, in the United States, the image of the small business owner left largely unfettered to create novel products and services sits on the same cultural plane as baseball and apple pie, and one would be hard-pressed to find a policymaker who would openly question the wisdom that most new jobs arise either directly or indirectly from these small businesses. This near religious belief in the small business owner as job creator yields a steady stream of policies offering tax relief to small businesses, often specifically tied to their behavior as job creators, as well as broader proposals that aim to cut the red tape that could hinder a business's ability to raise capital or to safeguard its intellectual property. Not surprisingly, these policies and their potential to improve macroeconomic outcomes become particularly salient during times of high unemployment.

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An Economic Approach to Job Quality

The short answer is no, at least when one examines data from the Kauffman Firm Survey (KFS), a dataset whose collection is sponsored by the Ewing Marion Kauffman Foundation. In a preliminary analysis of 4,928 new businesses that commenced operations in 2004, for example, we show that just 31 percent of new businesses offer their fulltime employees—including their owners—any form of health insurance coverage'.[2] Economy wide over the same 2004-2009 period, roughly twice that share of all employers offered a health care plan to full-time workers. Similarly, just 15 percent of the new businesses in the KFS offered their full-time workers any form of retirement or pension plan, inclusive of 401 (k) plans as well as other defined- contribution plans. The latter include SEPs (Simplified Employee Pension) and SIMPLE (savings incentive match plan for employees) plans specifically tailored to small business owners and their employees. Nationwide, about 50 percent of employers, at all stages of the business life cycle, report offering some form of retirement plan.

Admittedly, health and retirement benefits make up a narrow and decidedly economic slice of what constitutes job quality. Nonetheless, knowing that the employment relationship is the primary conduit through which Americans under the age of sixty-five are expected to secure their health insurance and retirement savings, it is clear that jobs that do not offer these benefits inflict significant hardship on workers and their families.[3] This hardship ripples across the economy in the form of depressed consumption on the part of workers and an increased burden on both the public and private sectors to support those who cannot support themselves. It also challenges policymakers and, perhaps, entrepreneurs themselves, to take action to address the crisis in job quality.

Entrepreneurs as Low-Quality Employers?

Entrepreneurs per se are *not* bad employers. Indeed, a more psychologically oriented approach would likely reveal that the jobs created by the KFS firms avail their incumbents of comparatively high levels of nonpecuniary rewards, such as job enrichment, job satisfaction, and autonomy.[4] Even by our narrow, economic operationalization, entrepreneurs fare well, particularly with respect to health insurance. Consider that the mean entrepreneurial establishment had just two- and-one-fourth workers and, as noted above, still offered almost one third of them health care. By our estimates, once a new firm survives and grows to about ten workers, its likelihood of offering health care coverage converges with the economy-wide probability that *established* businesses of *any* size offer health insurance. This highlights the importance of scale as a driver of health care coverage, a statement that similarly applies to the analysis of pension incidence.

Of course, the reality is that most entrepreneurial businesses are very small, and the negative impact of scale diseconomies on benefits offer rates is well- predicted and large in magnitude. But entrepreneurs are encumbered by more than just their small size. They are also more likely to be resource-constrained in the sense that they do little more than break even, leaving them little in the way of profits or other economic rents from which to fund conventional employee benefits. Furthermore, they are less likely to be susceptible to institutional pressures that often arise through serving high-profile public sector customers or from unions seeking to "organize discontent" by shining light on unenviable employment conditions.

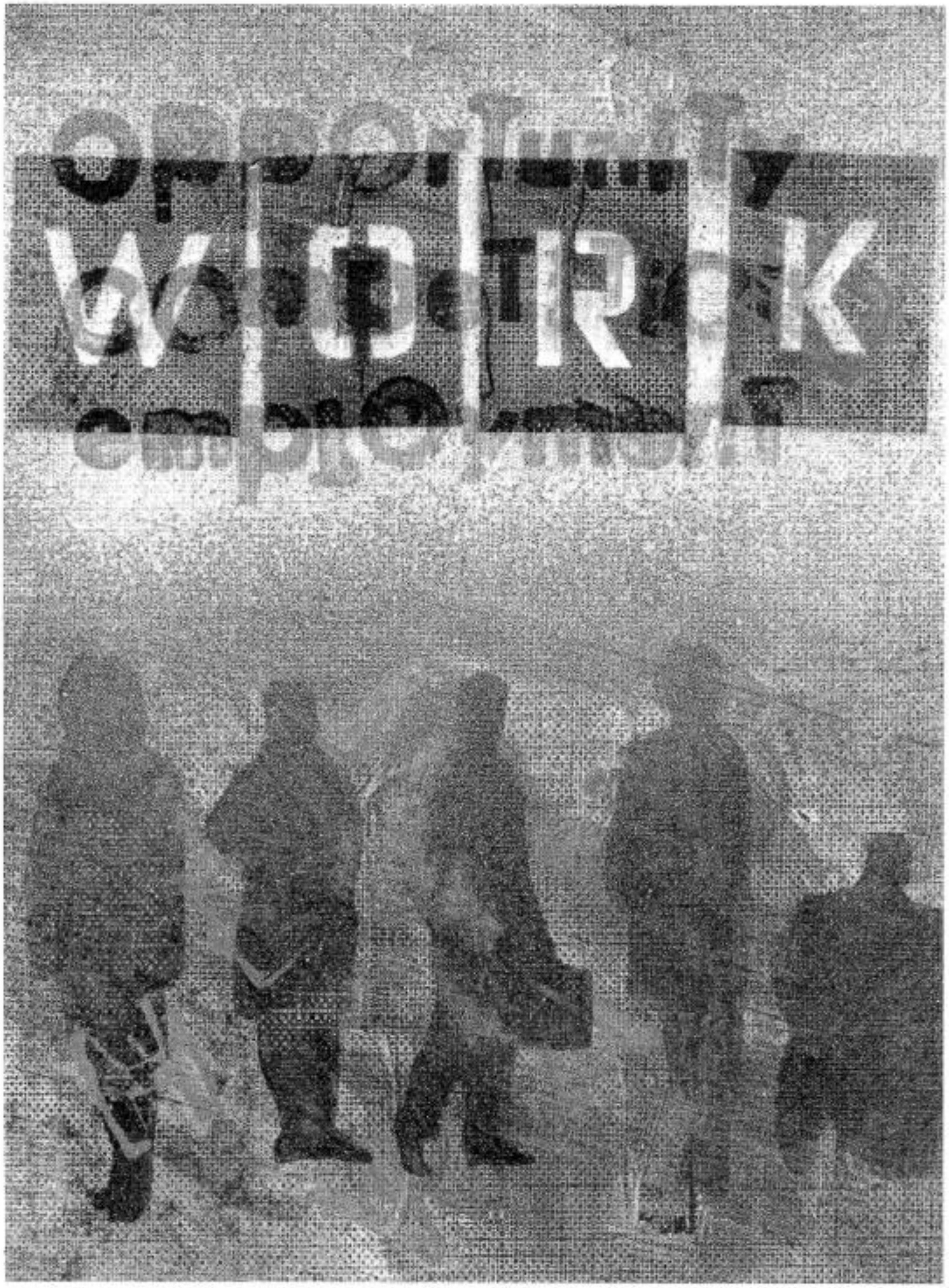
These findings, particularly with respect to scale diseconomies and resource constraints, suggest that the blame for poor job quality should not fall squarely and solely on the shoulders of entrepreneurs themselves. As it stands, intense product market competition, frequently centered on price, presents entrepreneurs with a dilemma: Should they adopt "high-road" employment practices that shift their costs significantly above those of their low-cost competitors, potentially suffering lethal economic consequences? Or, should they eschew the high road, like their upstart and established competitors, by offering jobs of low quality?

The Role for Entrepreneurs and Policymakers

An important first step, one that entrepreneurs can take on their own, is to ask themselves whether this choice is really a false dichotomy. Recent work by Paul Osterman and the late Beth Shulman suggests that in a limited set of cases, it may well be.[5] They remind us that there are often real economic gains to treating employees better. These can come about either directly through increases in discretionary effort or indirectly, through reductions in turnover. That is, to the extent that high-road employment practices reduce turnover, they also reduce the costs associated with recruitment, hiring, and training, not to mention periods of low productivity as new hires are on-boarded.

Nonetheless, entrepreneurs, particularly those operating in price-competitive product markets, may often be correct to believe that customers would penalize them immediately and severely were they to enact a high-road employment model founded upon high-quality jobs. What is more, one can argue that irrespective of whether or not an entrepreneur has room to maneuver, she should not be burdened with a decision of whether or not to provide high-quality employment opportunities. Moreover, questions regarding health care and retirement benefits should not have to figure into the marginal calculus associated with the founding decision or other decisions around innovation. Where they do, it puts our entrepreneurs at a disadvantage relative to their international counterparts, many of whom operate in advanced industrial economies in which the state assumes or at least shares in the burden of providing health care and pensions.

These circumstances illuminate a potential policy opportunity. That is, even programs that successfully prop up entrepreneurs—perhaps as a means of bailing out a sinking economy—are unlikely to create high-quality jobs, a fact that assuredly dampens the macroeconomic basis upon which these policies are founded. Short of alleviating new businesses of the burden of health and retirement benefits altogether, there are additional options for ensuring that policies that encourage new business formation also incentivize the creation of high- quality jobs. These ideas stem from our aforementioned analysis of the drivers and deterrents of job quality in new firms.



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First, given the primacy of size, policy must address the high fixed costs—be they actual or perceived— associated with the provision of health insurance and pensions. Indeed, with respect to both health care and retirement benefits, much of the heavy lifting of policy creation has already occurred. However, entrepreneurs may be unaware of the steps taken to facilitate their provision of health and retirement benefits. For example, the Affordable Care Act of 2010 includes a tax credit intended to encourage small businesses to provide health care. Likewise, the establishment of SEPs (under President Reagan) and SIMPLE plans (under President Clinton) facilitate for small business owners the provision of tax-qualified retirement savings vehicles akin to the 401 (k) that is now ubiquitous across large private- sector employers.

Second, given the link between a business's having public sector customers and its likelihood of offering health and retirement benefits, government procurement can be used to spread the fruits of high-quality employment opportunities. This puts an interesting and positive twist on the structural increase in government outsourcing. While the primary effects of substituting private-sector contract workers for conventional public employees may be detrimental to employment standards, a secondary effect could be to boost standards in a more geographically expansive manner as small pockets of high-quality jobs are created in communities across the country. Aside from the direct and immediate impact this would have on those employed by start-ups and young firms, it would have an indirect impact that could ultimately be even greater. Namely, it could work to reshape norms by establishing (or re-establishing) higher standards for private-sector job quality writ large, beyond those specific businesses that trade with the government.

The Road Ahead

With a better sense of the state of play with regard to jobs in new firms, the next step is to think critically about the role of job quality as both a driver of performance and as itself the product of other organizational, institutional, and market-related structures and processes. For example, it would be useful to know whether entrepreneurs who take the high road face differential prospects for survival. Likewise, how does a firm's behavior in capital markets—by what means and from whom they receive their financing—impact the type of employer they ultimately become?

Just as it is clear that we have much to learn about the nature of employment relationships in entrepreneurial firms, eventual success on this front requires that we make such learning a priority. If the ethos and actuality of entrepreneurial ingenuity is to continue to drive our economy, we must find ways to ensure that in the course of doing what entrepreneurs are meant to do—create new products and new businesses—they are also serving the economic interests of society-at-large. Given what appears to be a crisis in job quality, policymakers must work to create incentives for entrepreneurs to create high-quality employment opportunities.

Notes

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