Economic Studies
at BROOKINGS

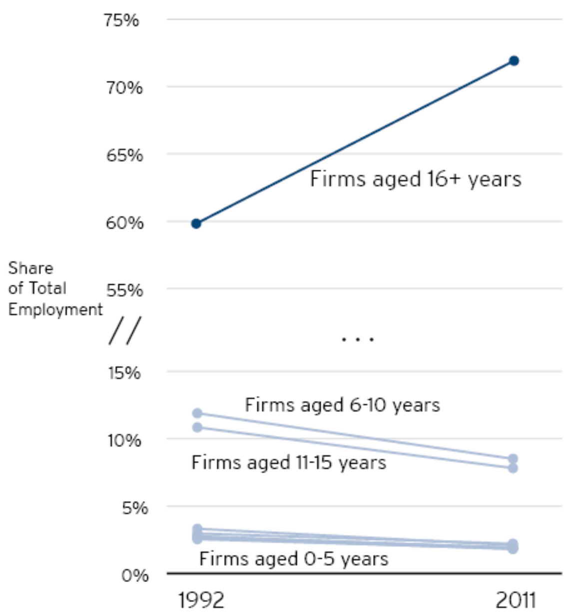
Older, Entrenched Firms Growing; Entrepreneurs Struggling in All Sectors, New Brookings Paper Finds

Share of Older Firms Has Increased by Half in Last 2 Decades; All Other Aged Firms Declined

When Incumbent, entrenched firms in all sectors of the economy and throughout all areas of the United States represent a larger share of all firms than at any time in the past 2 decades -- developing more of an advantage in the current economy than younger, entrepreneurial firms -- which could have negative consequences such as lower productivity, less innovation, and fewer new jobs created, according to a new paper by Brookings Nonresident Senior Fellow Robert Litan and economist Ian Hathaway.

Figure 2.

Distribution of Total Employment by Firm Age, 1992 v. 2011



Source: U.S. Census Bureau, BDS; authors' calculations

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In "The Other Aging of America: The Increasing Dominance of Older Firms," Litan and Hathaway's follow-up to an earlier paper finds that the share of firms aged 16 years or more was 23 percent in 1992, but leaped to 34 percent by 2011—an increase of 50 percent over the 20-year period for which data is available. The share of private-sector workers employed in these mature firms increased from 60 percent to 72 percent during the same period. Perhaps most startling, they found that employment and firm shares declined for *every other* firm age group during this period.

"Like the aging that is well-known among the population, the business sector of United States also appears to be getting 'old and fat,'" they write. "However, it appears that it is getting fat because it is getting old—not the other way around. This is an important point for public policy."

Exploring the potential contributing factors of this "other aging" phenomenon, Litan and Hathaway find that the major driver of the aging of the firm structure is a decline in the rate of new firm formations, which fuels a path-dependent process of fewer young and medium-aged firms maturing through the pipeline from the start, compounded by an increase in business failures at each firm age category except for the most mature firms. The uptick in business failures has been the most pronounced for the very youngest of businesses, and may be a contributor to the decline in new firm formations after 1990 as well.

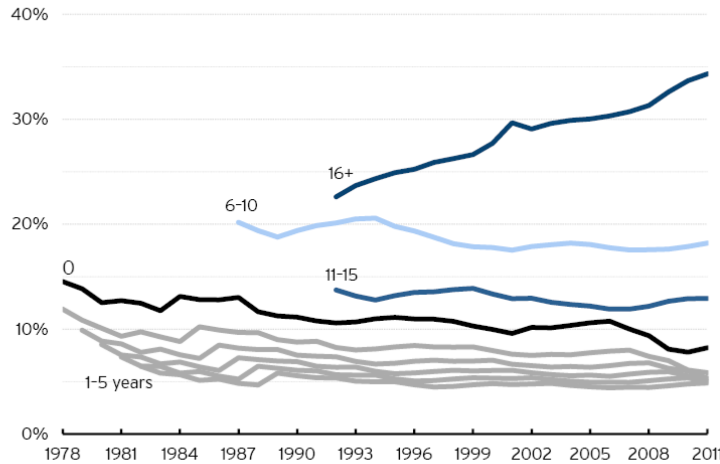
However, contrary to conventional wisdom, they did not find strong evidence of a direct link between business consolidation and an aging firm structure; although they did find a clear rise in consolidation, it doesn't appear to be a major contributor to business aging specifically.

Whatever the reason, they find that it has become increasingly advantageous to be an incumbent, particularly an entrenched one, and less advantageous to be a new entrant.

"The trends described here raise some cause for concern in our view," Litan and Hathaway write. "Holding all factors constant, we'd expect an economy with greater concentration in older firms and less in younger firms to exhibit lower productivity, potentially less innovation, and possibly fewer new jobs created than would otherwise be the case."

"The decline in the startup rate, coupled with the rising share of mature firms in the economy, is especially disturbing because new firms rather than existing ones have accounted for a disproportionate share of disruptive and thus highly productivity enhancing innovations in the past—the automobile, the airplane, the computer and personal computer, air conditioning, and Internet search, to name just a few. If we want a vibrant, rapidly growing economy in the future, we must find ways to encourage and make room for the startups of the future that will commercialize similarly influential innovations," they conclude.

Figure 1.
Distribution of Total Firms by Firm Age in Years (1978-2011)



Source: U.S. Census Bureau, BDS; authors' calculations

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The authors believe policymakers can buck these trends by adopting policies that better facilitate entrepreneurship, as mentioned in their earlier paper:

- Expand the numbers of immigrant entrepreneurs granted permanent work visas to enter and remain in the US;
- Allow foreign graduates of US schools who concentrate in the STEM fields to remain in the US to work for other enterprises, especially given the historical pattern indicating that immigrants are twice as likely to launch businesses as native-born Americans;
- At the state and local level, governments, educational institutions, entrepreneurs, investors and foundations should continue to experiment with ways to encourage new business formation. The increasing popularity of "business accelerators" throughout the country is a welcome development that should be nurtured.