

Why are entrepreneurs important for society?

Entrepreneurs have a positive influence on many aspects of society. Besides challenging existing companies and thus contributing to increased economic efficiency, startups also have a positive influence on job creation.

Early focus on the relation between startups and job creation

Already in the end of the 1970s and in the 1980s David L. Birch's groundbreaking research sparked the interest in entrepreneurship as the primary mechanism for job creation and increased competitiveness. Birch's research influenced politicians and decision makers as well.¹ Birch examined not only which companies contributed most to the creation of jobs, but also in which companies these jobs were created. The general results of Birch's studies about job creation in USA were that:

- On average, 60 per cent of all new jobs in the USA were created by companies with 20 employees or less, and approximately 50 per cent of them were created by independent small companies, while 15 per cent were generated by large companies with more than 500 employees.
- Not all small companies generated jobs; as soon as the small and independent companies were more than 4 years old, there was a significant decrease in job creation.

Birch moreover demonstrated that these results did not vary significantly between sectors.²

So startups seem to generate new jobs, but what other benefits to society do they bring? And what are the effects of new companies on the already established companies?

Increased competition contributes to a higher efficiency

When startups enter an existing market with already established companies, competition increases, as startups and established companies compete for the same market shares. When new companies enter a market, two things happen: 1) a large part of the new companies are unable to be sufficiently competitive and as a result leave the market, and 2) the new companies succeed in becoming so competitive that existing companies either lose market shares or must leave the market altogether. This mechanism ensures that only the most competitive and effective enterprises remain in the market.

Thus, increased competition as a result of more entrepreneurial activity is good for society, because it helps to increase effectivity, strengthen the innovation capacity and in this way generate more types of product and problem solutions, which benefits the consumer in the end.³

Positive effect on job creation in the long run

Based on the above mechanism it is possible to describe the over-

all effects on job creation. The effects are divided into the short-, the medium-, and the long-term effects.

Short-term effects: As new companies enter the market – and in pace with the employment of staff by some startups – job creation will increase in the short term.

Medium-term effects: After a period of increased job creation, where new companies have challenged established companies, the most inefficient companies will dismiss staff or leave the market altogether – this goes for startups as well as for established companies. The most productive companies will stay in the market and, because they are more productive, they will need fewer employees. As a result, the employment rate will decrease. This means that the effect on job creation in the medium term is negative.

Long-term effects: Now only the most efficient and competitive companies are in the market. The effects on job creation in the long term can be ambiguous, but according to Mirjam van Praag & Versloot (2007), the positive effect will dominate and lead to a positive net effect in the long term. In addition, entrepreneurial companies will generate positive benefits in other sectors, which will create further job creation in the long term. This generation of new jobs will not only appear in the new companies but also in for instance older and more established companies.⁴

The above pattern is confirmed in the comparative analysis by Mirjam van Praag & Versloot (2007), on a regional as well as on a national level.

A study by Malchow-Møller et al. (2011) about startup companies' job creation in Denmark shows that entrepreneurs generally stand for 25 per cent of the total job creation, while "actual entrepreneurs"⁵ are responsible for 8 per cent of the total job creation in the Danish economy.⁶

Startups are at least as productive as established companies

The analysis by Mirjam van Praag, C. & Versloot compares several studies that focus on the productivity of startup companies and established companies. The results unequivocally show that in the introductory years startups are less productive than established companies, but due to the higher growth rate of startups, they will in the long run catch up with the production level demonstrated by established companies in the control group.⁷

A Danish study, which focused on startups and established companies, concluded in line with the above that the total productivity of startup companies is one and a half times as large as the productivity of established companies.⁸

¹ The Job Generation Process (1979) og Job Creation in America (1987).

² Lundström, H. (2012). David L. Birch's Contribution to Entrepreneurship and small Business Research. Global Award for Entrepreneurship Research.

³ Fritsch M. (2008). How does new business formation affect regional development? Introduction to the special issue. Small Business Economics, 30:1-14.

⁴ Mirjam van Praag, C. & Versloot, P. H. (2007). What is the value of entrepreneurship? A review of recent research. Small Business Economics, 29:351-382.

⁵ That is, those with a first-time VAT registration for a company that has not previously been driven by someone or driven as another form of company, and the owner of which does not already have a VAT number

⁶ Malchow-Møller, N.; Schjerning, B. & Sørensen, A. (2011). Entrepreneurship, job creation and wage growth. Small Business Economics, 36(1), 15-22.

⁷ Mirjam van Praag, C. & Versloot, P. H. (2007). What is the value of entrepreneurship? A review of recent research. Small Business Economics, 29:351-382.

⁸ <http://www.rockwoolfonden.dk/artikler/ivaerksaettere-giver-bedre-loen-og-er-mere-produktive/>

