SMALL BUSINESSES AND JOB CREATION

MARCH 2008

- **FEDERAL AND STATE POLICIES TRY TO ASSIST SMALL BUSINESS DEVELOPMENT AND GROWTH.**
  Paralleling federal efforts, California's Department of General Services offers a number of advantages – most importantly bidding preferences – to small and micro businesses. Many state agencies also employ a small business advocate to help resolve contracting issues with the state. Such policy efforts presume that small businesses are an important source of employment growth. In addition to these explicit attempts to help small businesses, proposed business taxes and regulations in California are frequently discussed in terms of their likely effects on small businesses.

- **CALIFORNIA'S SMALL BUSINESSES CREATE JOBS AT A FASTER RATE THAN LARGE BUSINESSES…**
  The gross rate of job creation – the absolute number of jobs generated due to business births, expansions, and migration into the state, as a share of employment – is generally higher at businesses that employ fewer workers. Between 1992 and 2004, the annual gross rate of job creation was 14 percent at establishments with 0-19 employees, compared to 7.5 percent at establishments with 1,000 to 2,499 employees and 3.7 percent at establishments with 5,000 or more employees.

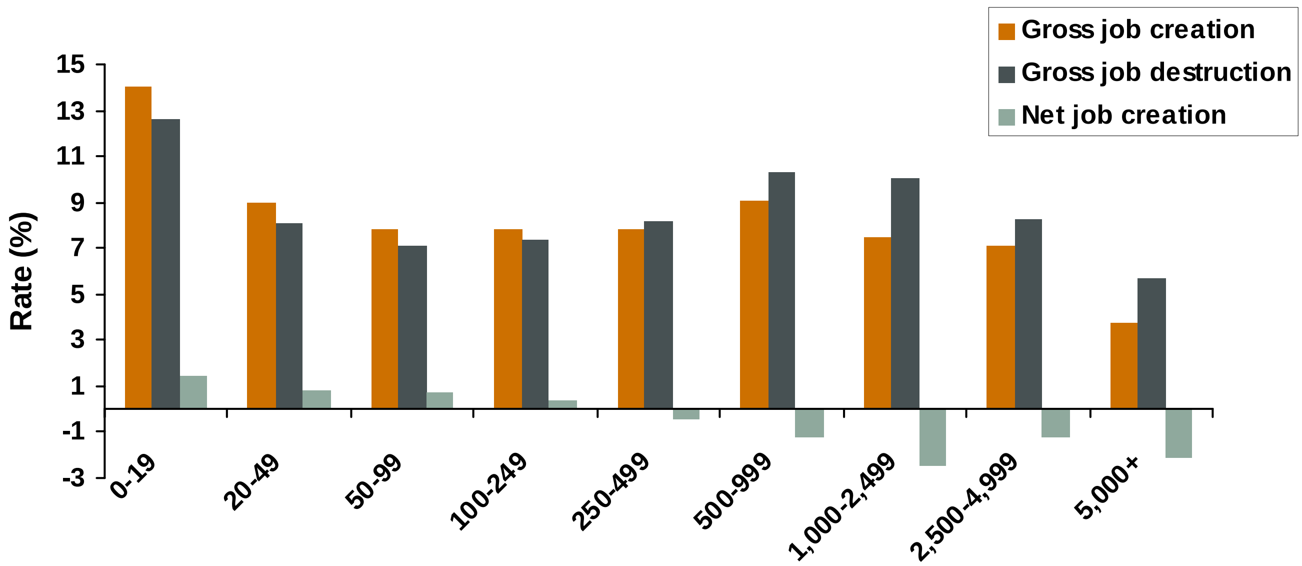
- **… BUT THEY ALSO SHED JOBS AT A FASTER RATE.**
  Between 1992 and 2004, California's annual gross rate of job destruction (jobs lost due to business contraction, closure, or out-migration) was 12.6 percent at establishments with 0-19 employees but only 5.7 percent at establishments with 5,000 or more employees. However, outside the smallest size categories, the relationship between gross job destruction rates and establishment size is less clear, with rates rising and then falling again among businesses of various size (see figure).

- **THE NET JOB CREATION RATE HAS BEEN HIGHEST AMONG SMALLER BUSINESSES…**
  Net job growth is the difference between gross job creation and gross job destruction. Between 1992 and 2004, the net job creation rate was highest at the smallest establishments, implying that ultimately, smaller establishments contribute more than larger ones to employment growth. In this time period, the annual net job growth for businesses with 0-19 employees was 1.4 percent, falling to 0.4 percent for those with 100-249 employees.

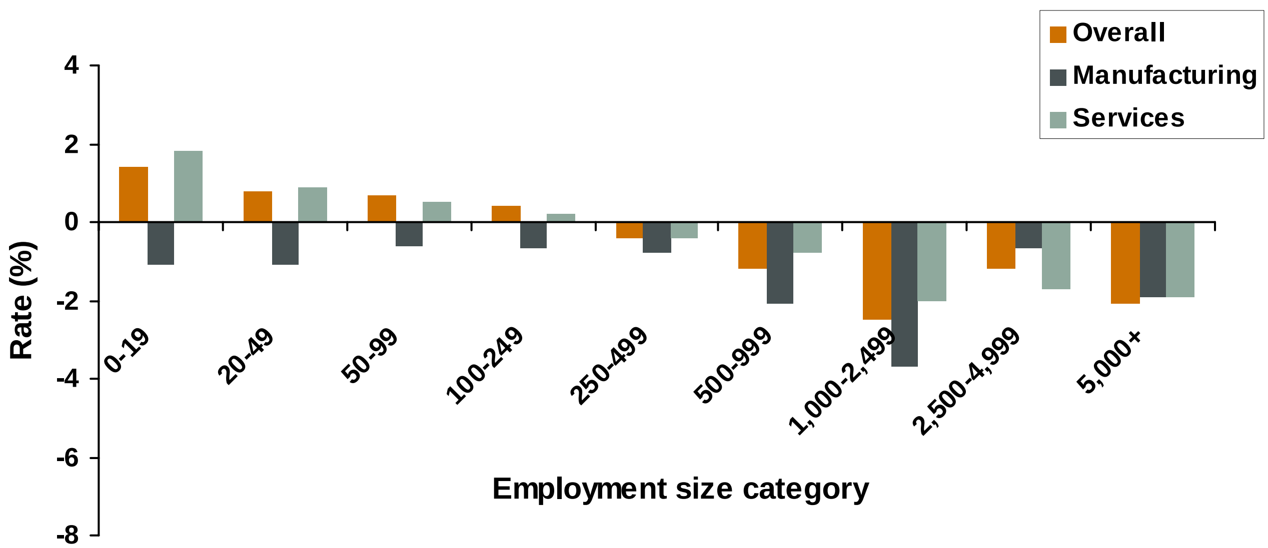
- **… WHILE IT HAS BEEN NEGATIVE AT LARGER BUSINESSES.**
  On average, between 1992 and 2004, business establishments with more than 250 employees lost jobs – with a *negative* net job creation rate of −0.4 percent among establishments with 250-499 employees and −2.1 percent among businesses with 5,000 or more employees.

- **SIZE-GROWTH RELATIONSHIPS DIFFER ACROSS INDUSTRY SECTORS.**
  In manufacturing, businesses in *all* size categories lost jobs in the 1992-2004 period, with smaller manufacturing establishments contracting at about the same rate as the largest manufacturing establishments. In the services sector, however, small businesses played an important role in job growth. The smallest business establishments in the services sector gained jobs at a rate of 1.8 percent, while larger service establishments lost jobs, with the sharpest decline (−1.9 percent) occurring among establishments with 5,000 or more employees.

Job Creation and Destruction, 1992-2004



Net Job Creation by Industry Sector, 1992-2004



Source: David Neumark, Brandon Wall, and Junfu Zhang, "Do Small Businesses Create More Jobs? New Evidence from the National Establishment Time Series," NBER Working Paper No. 13818, Cambridge, Massachusetts, 2008.

Note: Rates of job creation and destruction from year *t* to year *t+1* are computed relative to average employment in the two years.