An Entrepreneurial Recovery

Big business gets the headlines, but thousands of upstart companies do most of the heavy lifting in the American economy.

BY CARL SCHRAMM AND ROBERT E. LITAN

No more Rodney Dangerfield moments in Washington for entrepreneurship: At long last, it's getting some respect. Although he was not elected on a platform aimed at helping entrepreneurs, President Barack Obama, facing the highest unemployment rate the nation has experienced in nearly three decades, is beginning to move them toward the center of his economic recovery plans. He embraced entrepreneurs near the beginning of his 2010 State of the Union address and has since outlined a series of steps to encourage "small business" to create new jobs: \$33 billion in tax credits for hiring new workers and \$30 billion in low-interest loans (from the Troubled Asset Relief Program) intended to spur community banks to lend to small business.

As a nation, we have tended periodically to forget the crucial role of entrepreneurs in our economic success. During the early 1970s, the U.S. economy was mired in a recession almost as deep as the current one, and citizens and policymakers alike worried for more than a decade that the United States was being eclipsed by Japan. Then, with some help from Washington, though not a lot—lower capital gains taxes and changes in pension rules that allowed the managers of pension assets to invest in venture capital funds—a legion of rising entrepreneurial companies transformed the economy. Few saw this change coming. All eyes were on the increasingly sclerotic large companies (think General Motors and U.S. Steel) that had dominated the economic landscape for more than a generation. The new firms—Intel, Apple, Microsoft, Federal Express, and many others—created not only millions of new jobs but what is, in effect, a new world.

People instinctively understand the importance of entrepreneurs. When asked in September 2008, at the height of the financial crisis, on whom the health of the economy depended, 70 percent of those in a survey sponsored by our foundation answered "entrepreneurs." This faith is not misplaced. A study by current and former Census Bureau researchers shows that virtually all of the net new jobs created in the United States between 1980 and 2005—roughly 40 million—were generated by new firms (five years old or younger). This is a remarkable statistic, for what it means is that all other firms collectively hired no more people than they let go: On net, they hired no one. A follow-up study focusing on 2007 found that this pattern had essentially continued. New firms accounted for two-thirds of net new jobs (hiring minus downsizing). The clear implication of these

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Americans launch more than a half-million businesses a year, even in recessions. Helping them grow is mostly a matter of creating the right conditions.

data: If policymakers want greater job creation, they should focus on the formation and growth of new firms. (The same lesson applies abroad, we believe, although good internationally comparable data do not exist.)

For rapid job and income growth, however, some new firms are better than others. It is the ones that "scale"—that grow rapidly in sales and employment—that disproportionately create new jobs and in the process are most likely to generate huge spillover benefits for other firms and people throughout the economy. Such firms (Apple and Google, and Microsoft when it was younger) are typically the vehicles for diffusing the radical innovations that transform the economic and social landscape and thereby do the most to raise our standard of living. In the past, such new firms gave us the automobile, air conditioning, the airplane, computers and most of the software written for them, and Internet search engines. We can't be sure what tomorrow will bring in emerging fields such as clean technology, bioengineering, and nanotechnology, but we can be sure that most of what they bring will be the product of innovative small firms that are unknown (or unborn) today rather than brand-name corporate behemoths.

Isn't this the worst of all possible times to start a business? Banks aren't lending to any but the safest borrowers. Consumers are scared by persistently high unemployment. But if history is any guide, we don't need to worry a great deal about these negatives. Since the 1990s, the number of new companies launched annually—from doughnut shops to biotech firms—has remained more or less constant at about 700,000. Half of today's Fortune 500 corporations were launched in either a recession or bear market. The same is true of the firms on *Inc.* magazine's annual list of the fastest-growing U.S. companies. The silver lining of recessions is that they bring down the cost of rent and labor. Furthermore, vastly cheaper computing and telecommunications make it easier to start and grow a business than ever before.

The current recession nonetheless may impede the growth of the future wannabe Microsofts and Apples, especially if those companies are in businesses that require lots of up-front capital, such as alternative energy or biopharmaceuticals. We won't know for several years whether we can count on the positive historical experience with start-ups in recessions repeating itself. But by then it will be too late, and meanwhile roughly 10 million jobs have disappeared and don't look like they're coming back very fast. Even the president's own Council of Economic Advisers is projecting that the unemployment rate will not fall to its pre-recession level until *2020, or maybe later*. That's not good enough. We need smart policies to encourage the formation and growth of many more new "scale" companies.

Some have suggested massive government jobs programs, like the New Deal–era Works Progress Administration, to get more people back to work. Even if we had the money and the political consensus for such an approach—which we do not—this would not produce the fresh crop of scale private-sector firms needed to sustain rapid growth over the long run. Nor is it likely that large existing firms, having downsized bigtime in this recession, are going to hire massive numbers of the currently unemployed.

Not having a lot of government money to spur new company formation and growth is not the end of the world, however. Ultimately, the ground rules that government sets for those who start and grow companies are more important than any money Washington might provide. Changing a few of these rules would go a long way toward encouraging more scale entrepreneurship that we urgently need now.

Import entrepreneurs: Let's begin by recognizing the shortsightedness of our current approach of giving talented foreigners temporary visas to come to the United States to study or work in a high-tech environment and then forcing them to go home. Roughly a million highly trained workers who are in the country on six-year H1-B visas will have to return after their visas run out. But why should they be sent home when, as the University of California's AnnaLee Saxenian and Duke's Vivek Wadhwa have documented, skilled immigrants found or cofound 25 percent of successful U.S.-based high-tech companies?

Ideally, our immigration laws should be changed so that every immigrant who earns a scientific or technical degree at an American university also gets a green card stapled to his or her diploma. That would give approximately 60,000 highly trained people a year a shot at contributing to America's future.

If this proposal is too politically ambitious—because of fears that immigrants will "take jobs away" from other Americans—the United States should at least establish a job creator's visa for immigrants who start new companies. Visa recipients might include graduates of our schools, workers with expiring H1-Bs, and even people who arrived in the United States on tourist visas. One proposal in circulation would reduce the amount of capital immigrant entrepreneurs must post in order to qualify for legal entry into this country (currently $1 million). That is a good idea, but a better one would be to permit entry by immigrants with the skills but not the money to launch companies. It would make sense to give them a chance by providing a grace period in which to establish a business, extending their stay once they begin hiring workers, and then granting them the equivalent of a green card once their employee count passes some threshold (say, five workers).

By definition, immigrants who make jobs for Americans don't take them away from other Americans. Even the most ardent opponents of looser immigration policies surely can understand this.

Encourage university entrepreneurs: Much if not most new knowledge being created every day comes to light in our nation's research universities. There is a law—the Bayh-Dole Act of 1980—that was passed to encourage the diffusion of this research, by giving the universities intellectual property rights in the commercialization of federally funded research (more than $30 billion annually). Yet in their efforts to coordinate management of their faculties' commercial activities, universities have unintentionally developed barriers to rapid commercialization of many inventions by requiring faculty innovators to work only through the universities' own technology licensing offices (TLOs). This practice is analogous to requiring professors to publish only through their home universities' presses, which of course is never done because it is recognized that it would exert a deadening influence on scholarship. The TLOs, in search of one or two "home runs," are typically overburdened, and often do not have the time or resources to handle the commercialization opportunities of many or most faculty members. There is an easy fix: Allow competition in licensing (while leaving in place agreements splitting royalties between faculty and their employers) by allowing faculty innovators to choose their own licensing agent. The federal government can push this along by requiring universities to allow this sort of academic freedom as a condition for receiving federal research dollars.

Make it easier to go public: In the wake of the corporate accounting scandals that ensnared Enron and other companies a decade ago, Congress in 2002 enacted the Sarbanes-Oxley Act, imposing a bundle of new auditing and corporate governance requirements on all publicly traded companies. It was thought that Sarbanes-Oxley would impose very few additional costs while vastly improving the accuracy of corporate financial disclosures. Since then, costs have proven to be much higher, while the number of companies going public has dropped sharply.

FLEDGLING COMPANIES that are bought by larger firms seldom reach their full potential.

If it is too expensive to go public, successful companies in need of capital for expansion will find it more attractive to sell out to bigger firms. But the larger and usually more bureaucratic acquirers can kill the entrepreneurial spirit and innovativeness that drove the companies to be successful in the first place. Neither Skype (acquired by eBay) nor YouTube (bought by Google), for example, have become the commercial successes they might have been had they gone public. Suppose that Microsoft had sold itself to IBM instead of going public. Does anyone seriously think it would have been as successful an IBM-managed company?

There are solutions for this. Either exempt smaller companies from Sarbanes-Oxley (as a bill passed by the House of Representatives would do) or, better yet, let shareholders vote on whether their companies should adhere to the law's most onerous provisions, such as verification of the adequacy of their internal controls (an expensive process that audit firms largely do by "checking the boxes"). That is the approach suggested by economist Henry N. Butler and law professor Larry E. Ribstein.

Legitimate entrepreneurship as a worthy career path: Young people who tell their parents that they want to start a company are likely to hear groans and loud warnings about all the risks. That is not the message they should be hearing. We need to encourage American youth to be venturesome. For years, our foundation has supported the teaching of entrepreneurship at the college level as a way to expose students to what it takes to be an entrepreneur. Such courses are useful, but as with so many things in life, people are most inclined to benefit from instruction when they are actually engaged or about to be engaged in the activity itself. That is why we see more immediate results from our shorter six-week course for working adults and our new one-week course for unemployed workers who are looking to shift careers.

At the college level, the most exciting things seem to be happening outside the classroom, in programs that are loosely affiliated with universities. The Launchpad program at the University of Miami provides an "entrepreneurs' door" at the university's career counseling center, which in its first 18 months attracted 1,000 students and spawned more than 20 businesses. The Massachusetts Institute of Technology's Venture Mentor program, which counsels MIT students and faculty engaged in entrepreneurial ventures, is the most successful effort of its kind in the country. Our own Kauffman Labs runs a competitive process for identifying and then mentoring and nurturing entrepreneurs whose businesses are likely to scale.

Young people ought to be encouraged to think about an entrepreneurial career even before they go to college. The Junior Achievement program and the inner-city–focused Network for Teaching Entrepreneurship already do good work at the high school level. William Green, the University of Miami provost who thought up Launchpad, has floated a simple but potentially powerful idea: Why not have colleges and universities ask applicants whether they have started a business, and if so, to describe what they have learned from the experience? Anybody who has seen the lengths to which students will go to get into good schools knows what will happen. That simple question would motivate many more students to try their hand at entrepreneurial activities, without costing a single federal nickel. It's the kind of acorn from which many oaks may grow. Add up the other acorns we have advanced here, and we might get back the economic forest we used to have. ■