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Start-ups slow down job creation, says expert

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GOVERNMENTS and policymakers are wrong to focus on supporting start-ups in the belief that helping first-time entrepreneurs to get off the ground will create jobs and transform depressed regions, says Scott Shane, professor of entrepreneurial studies, at the Weatherhead School of Management at Case Western Reserve University in Cleveland, Ohio.

In a paper published by the Research Institute of Industrial Economics, Shane said policymakers should stop subsidising the formation of the typical start-up and focus on the subset of businesses with growth potential.

"The vast majority of people founding new businesses aren't entrepreneurs in the sense of people building companies that grow, generating both jobs and wealth. Rather, they are founding wage-substitution businesses that have more in common with self-employment than the creation of high-growth companies."

He said this phenomenon was not only limited to the US but could be found across the 34 countries surveyed by the Global Entrepreneurship Monitor (Gem) report between 1998 and 2003.

He said that as countries become wealthier the rate at which they create start-ups goes down.

He attributes this to a range of factors, including that wealthier countries can generate more attractive wages that draw many into working for someone else.

He contends that rather than picking industries in which new companies are most successful, most entrepreneurs pick industries in which most start-ups fail.

Start-ups also create less jobs than existing business and it takes a lot of entrepreneurs to create lasting jobs, he argues.

"To get one business employing at least one person in 10 years we need 43 entrepreneurs to begin the process of starting a company. And how many jobs will that start-up have, on average, 10 years after it was founded? For the US, the answer is 9."

He said it meant that 43 people had to try to start companies so that the US could have 9 jobs a decade from now.

Shane contends that a tiny sliver of companies accounts for the vast majority of the contribution to job creation and economic growth that comes from entrepreneurial activity.

Responding to questions on how SA would fit in his study, Shane said policymakers in countries with high poverty and unemployment were faced with a dilemma.

There were two political problems when it came to aiming funds at more innovative businesses. The first, he said was that in many cases it takes a long time to create jobs through this process and people can't wait, especially when they vote in elections.

The second is that the creation of a small number of good jobs was seen as politically inferior in many cases to a larger number of temporary, poor jobs.

"So if elected officials can get a bunch of start-ups formed where the entrepreneur provides a job for himself for a year at 60% of the wage of someone employed by someone else, that is preferable for a lot of politicians to a situation where a smaller number of entrepreneurs create a smaller number of jobs that last longer and pay the prevailing wage, but take three years to create."

However, Wolfgang Thomas, professor in economics at the University of Stellenbosch Business School, argued that the high failure rate of start-ups simply meant that organisations and the government should increase, and not slacken off, support to those looking at setting up a business.

He said while Shane's argument might be suitable for those countries that already had quite expensive and sophisticated support programmes for small business, he believed SA was not spending enough on start-ups.

Thomas said the country's high failure rate of businesses meant more should be done to supply mentoring and business information to these businesses.