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Who Is Really Creating the Jobs this Recovery & Why?

It's Not Who You May Think

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The Great Recession as it has come to be known was declared over at the end of June 2009. The economy has therefore been "recovering" for over three years. By historical standards, employment should have recovered and the economy should be robust or at least performing nearer its potential. Nevertheless, it is not. Despite numerous Federal Reserve and Administration attempts to stimulate the economy, nearly every sector from consumer spending, employment, housing and commercial real estate are all bouncing along the bottom in a recovery which is the weakest since at least World War II.

Conventional wisdom (or perhaps political mythology) suggests that small business is the engine of the economy and the contributor of most jobs. Indeed, that was true prior to The Great Recession. Today however, big business is leading the jobs recovery and that may help explain the mediocre job creation. It may also suggest that recovery may take much longer than is widely expected.

Data from the Bureau of Labor Statistics (BLS) suggest that small firms actually did better *during* the recession. BLS Employment Dynamics data show that small firms (companies with fewer than 20 employees) cut back about two-percent from peak to trough while companies with more than 1,000 employees cut back by nearly 14%. This is surprising since small firms tend to be more dependent upon bank financing than large firms and financing virtually dried up during the recession. Large firms usually have more avenues open to them to raise cash. These avenues may include corporate bonds, equity issuance and commercial paper. The data reveal that not only did small firms experience fewer job losses during the recession, they actually cut back less on hiring than did larger firms. Larger firms often implemented rigid hiring freezes while the smaller and nimbler entrepreneurial companies hired as resources permitted and opportunities arose.

Labor Dynamics changed post recession. Larger firms have been hiring much more aggressively while smaller firms have languished. BLS data which is also confirmed by the payroll processing firm ADP, indicate that less than 30% of job gains since 2010 were the result of hiring by companies with fewer than 50 employees. The vast majority of new hires were by large companies. One explanation may be that since large companies in general cut deeper they have more to make up than smaller companies. Nevertheless, there are weaknesses in that theory too. Business dynamics data indicate that there are fewer new firms being formed today *and* those that are being formed are hiring fewer employees than they did historically. A study by the Hudson Institute, a Washington, D.C. based conservative think tank, shows that existing companies (big and small) tend to be net job losers averaging a net loss in aggregate of around 1.0 million jobs each year. New firms however, have historically gained 3.0 million jobs on average each year. Nevertheless even the size of a new firm has declined over the years. In 1998, the average size new firm has 6.4 employees. By 2011, the average size firm had fallen to 3.9 employees.

There appear to be numerous reasons for the change in labor dynamics and the shift to big companies being the predominant job creators. Reasons include the lingering effect of The Great Recession, business, tax and healthcare cost uncertainty, technology and cost saving techniques chipping away at employment, increased productivity and structural employment changes leading to more permanent than cyclical losses.

In our view, diminished home equity has also had a profoundly negative effect on small business. A significant amount of home equity has historically been used to fund entrepreneurial ventures. Today, in an era of seriously diminished home equity, entrepreneurs are often unable to start, or fund new ventures or grow existing small businesses. That leaves larger firms as today's primary job growth driver - at least for now.

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