Montana's Entrepreneurs

SMALL BUSINESS IS BIG IN MONTANA

by Emily Klungtvedt, Economist

When you think of Montana's entrepreneurs, what do you think of? The local construction company working on your house? Or a small law firm or accounting business? Maybe you think of the many food trucks that are conveniently located throughout town, or the breweries that seem to keep popping up over the last several years. No matter what comes to mind, it is apparent that Montana's entrepreneurs play an important role in the state's economy.

Evidence from Montana's income sources suggests that Montana is a leader when it comes to entrepreneurialism. Proprietor income makes up 10.1% of Montana's total personal income, higher than the U.S. average of 8.4%. And Montana is ranked third-highest among states for total personal income from dividend, interest, and rent (23.4% in Montana compared with 19.4% in the U.S.).[1] Both income sources suggest that Montanans are earning money from sources other than wages, such as business income, and are earning it at a higher rate than elsewhere. Because local entrepreneurs are so significant to Montana's economy, it is important to have a better understanding of entrepreneurship and business start-ups in Montana.

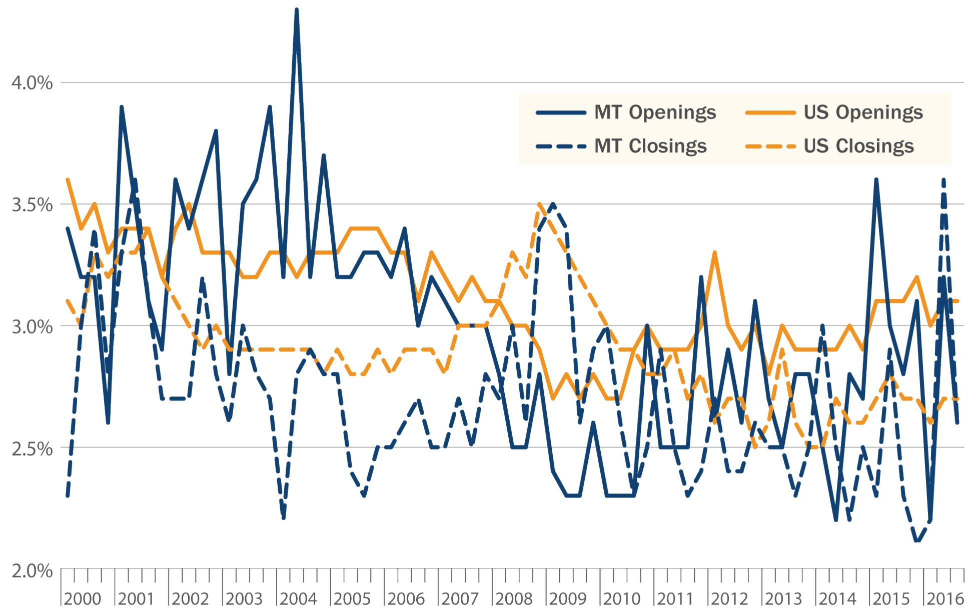
Survival Rates of New Business

Starting a business is risky. Entrepreneurs invest their time and money into a new business with the idea that the demand for their product or service will be sufficient for success. However, the number of businesses opening each year is only slightly higher than the number of businesses closing. Most recently, business openings made up 2.8% of existing businesses, while business closings made up 2.6%.[2]

1 U.S. Department of Commerce. Bureau of Economic Analysis. 2016.

2 Bureau of Labor Statistics. Business Employment Dynamics. 2015Q4 to 2016Q3.

FIGURE 1:
Business Openings and Closings
As a percent of total establishments



Source: BLS. BED.

Over time, establishment openings and closings follow the general trend of the business cycle, with a higher rate of startups during expansions and a lower rate during recessions.

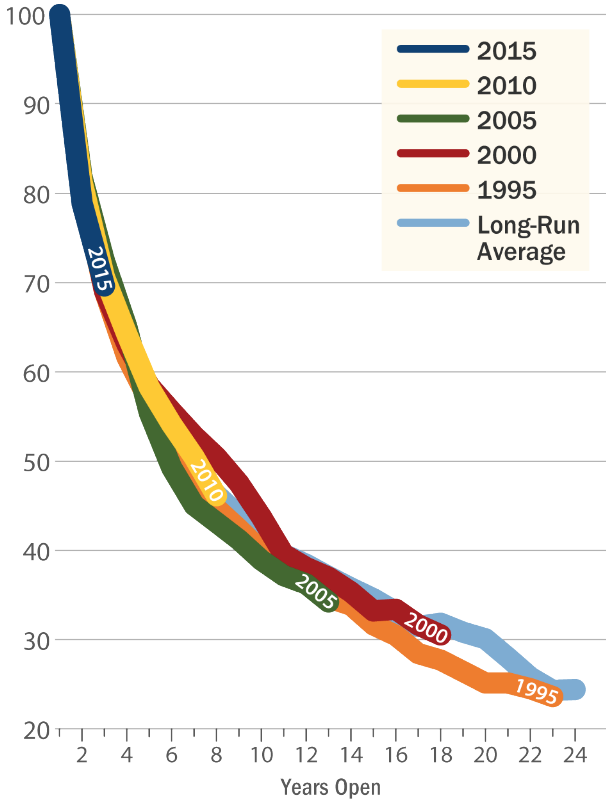
For example, Montana was adding businesses at a rate of 3.3% between 2004 and 2007. This rate dropped to approximately 2.5% during the recession, but it is back up to an average of 2.9% since 2015. Overall, Montana's business openings and closings are similar to the general trend in the U.S. **Figure 1** compares the U.S. and Montana's business openings and closings as a percent of total establishments.

Once an entrepreneur decides to take the risk and open a business, they have about an 80% chance of staying in business for at least one year, a 70% chance of staying in business for two years, or a 63% chance of staying in business for three years. Over time, as the entrepreneur gains experience and knowledge, the likelihood of failing slows down. This trend is relatively consistent over time, although the survival rates were slightly lower for businesses that started near the most recent recession.

Businesses that started in 2006 had a 57% chance of making it to year three (2009) and those that started in 2007 had only a 54% chance of making it to year three (2010) compared to the long-run average of 63%. **Figure 2** *(next page)* shows survival rates for Montana businesses.

Although starting a business is risky, starting a business in Montana has slightly less risk than the U.S. in terms of survival rates. While the one-year survival rate for new businesses in Montana is similar to that of the U.S. (79.8%

FIGURE 2:
Montana's Business Survival Rates



Source: BLS. BED.

compared with 78.6%), the likelihood of keeping a business running for five years is 52.6% in Montana, compared with 48.6% in the U.S. as a whole. The ten-year survival rate is 39.6% in Montana, compared with the U.S. rate of 33.5%.

New Businesses by Industry

In 2016, entrepreneurs created nearly 2,650 new business establishments in Montana.[3] The professional and business services industry and the construction industry added a high proportion of these businesses, at 26.4% and 15.0%, respectively, while the information industry added the fewest at 1.2%.

Part of the reason that some industries have more startups than others is simply because some industries are larger than others. **Figure 3** compares the percent of total establishments by industry to the percent of new establishments by industry.

FIGURE 3:
Percent of New vs. Total Establishments by Industry
2016

Source: US Bureau of Labor Statistics, Bureau of Economic Development

3 Bureau of Labor Statistics. Business Employment Dynamics.

However, some industries have a higher rate of startups than their overall share of business. For example, the professional and technical services industry makes up 26.4% of all new business establishments, but only 18.9% of total industry establishments.

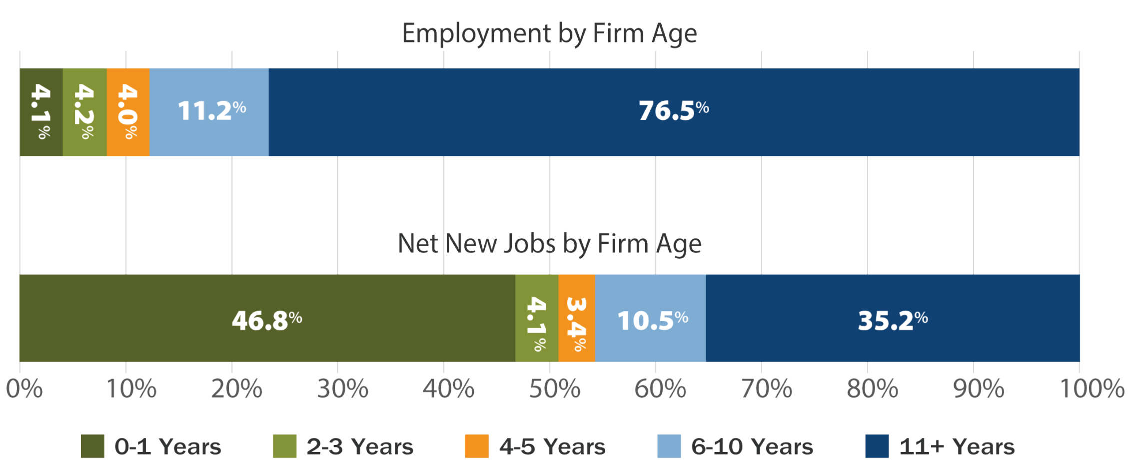
This difference can be partially explained by the overall difficulty of opening a business within a particular industry, which includes startup costs and other risks compared to the demand for the product or service. Starting a manufacturing company, for example, requires a large investment in equipment and machinery, which creates a barrier to entry in this market. Starting a law firm or accounting business in the professional and technical services industry, on the other hand, may be less expensive and therefore easier to achieve.

Employment by New Businesses

New businesses contribute to the economy both when they open, and as they grow to hire additional workers. As expected, newer businesses employ fewer workers than larger, more established firms. On average, younger businesses (firms less than five years old) employ about 44,000 people each year, or 12.2% of all employment. In comparison, firms older than ten years account for 76.5% of total employment. However, one of the main economic advantages of entrepreneurship is that it creates jobs that did not exist before, and new businesses create new jobs at a higher rate than older businesses. On average, 54% of net new jobs were created by businesses that had existed for five years or less, compared to 35.2% at firms older than ten years (or 45.7% at firms older than five years).[4] **Figure 4** shows this comparison.

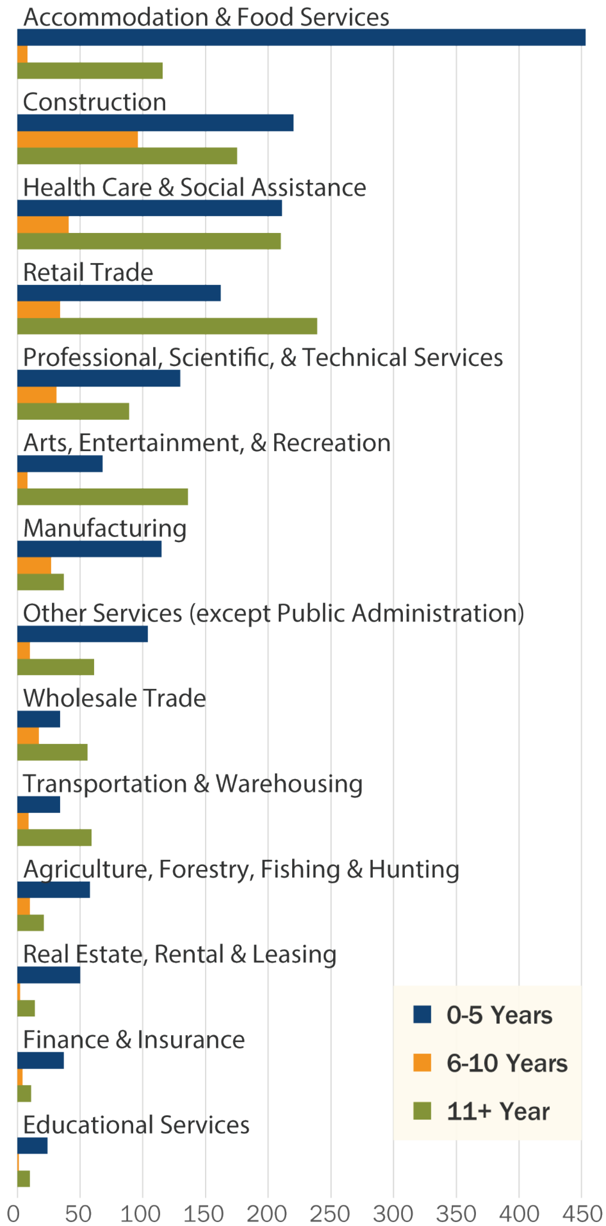
4 U.S. Census Bureau. Quarterly Workforce Indicators. Data is an average from 2012 to 2016.

FIGURE 4:
Employment and New Jobs by Firm Age
2012-2016 averages



Source: U.S. Census. QWI.

FIGURE 5:
Net Jobs Created by Age of Firm
2012-2016 average



Source: U.S. Census Bureau. QWI.

While net job growth is higher, on average, in younger businesses than older businesses, this difference is not true for each industry. **Figure 5** *(next page)* shows average annual net jobs created by industry and age of business.

The accommodation and food services industry added the most net new jobs (average of 577 jobs per year), and 79% of these jobs were in firms less than five years old (453 jobs). Most of the net job growth in the industry was in food services (417 jobs), and over 90% of these jobs were in young firms. One possible explanation for the large amount of jobs in younger firms in this industry is a relatively low barrier to entry. Rather than open a brand-new restaurant, entrepreneurs can take advantage of opening a franchise, which eliminates the risk of creating a brand and typically allows for hires immediately. Other lower start-up cost options include smaller cafés or food trucks.

The construction industry added the second most net new jobs (average of 493 jobs per year). However, unlike the accommodation and food services industry, new jobs were added more evenly over the age of the business. About 45% of new construction jobs were in young firms, 20% in firms six to ten years old, and 36% in firms over ten years old. Construction employment was significantly affected by the most recent recession, losing nearly 30% of total employment from 2007 to 2010. Because of the job loss, the subsequent expansion created significant demand for more business and more workers. While this demand helped new business startups, it also helped all construction businesses, regardless of age, to hire new workers.

The retail trade and the healthcare and social assistance industries are similar in that they each added over 400 jobs on average, but fewer jobs were added in firms less than five years old than the older firms. For healthcare, most new jobs were created in hospitals, which have considerably high startup costs, creating a barrier to entry. For retail trade, this industry simply does not have as many new businesses as other industries. **Figure 1** showed that while retail trade made up 10.6% of all industry establishments, new business in retail trade made up only 6.3% of all new establishments. The rise in online shopping has likely contributed to lower business startups in the retail trade industry.

The professional, scientific, and technical services industry added the fifth most net jobs, on average, over the last five years. Although it's a common assumption that employment growth in this industry is from newer businesses, employment growth by firm age depends on location. Yellowstone County added nearly 18% of new jobs in this industry, and 64% of these jobs were in firms greater than five years old. Flathead County added 12% of new jobs, but 66% of them were in firms less than five years old. Gallatin, Missoula, and Lewis & Clark Counties also added high percentages of net job growth, but about 50% of jobs were in young firms while 50% were in established businesses. **Figure 6** shows this net job growth by age of business.

FIGURE 6:

Job Growth in the Professional and Scientific Industry

Average net job growth in the top five counties, 2012-2016

	% of Net Growth	% From Businesses: 5 Years or Younger	% From Businesses: Older than 5 Years
Gallatin	29.2%	46.6%	53.4%
Yellowstone	17.6%	36.4%	63.6%
Missoula	14.4%	52.8%	47.2%
Flathead	11.6%	65.5%	34.5%
Lewis & Clark	8.8%	54.5%	45.5%

Source: U.S. Census Bureau. QWI.

And finally, while the manufacturing industry is known to have high startup costs that typically create a barrier to entry, over the last five years, Montana's manufacturing industry has had higher average net job growth in newer businesses than in older ones. One explanation for the increased employment in young firms is the increase in new breweries and distilleries. In fact, both brewery and distillery licenses have nearly doubled over the last five years.[5] Given this kind of growth, it's no surprise that young beverage manufacturing businesses account for 27% of net employment growth in Montana's manufacturing industry.

5 *Department of Revenue. Liquor Enterprise Fund Report of Operations. Available here https://mtrevenue.gov/publications/liquor-publications/*

Conclusion

Although being an entrepreneur can be risky, in 2016 alone, nearly 2,650 Montanans decided that the risk was worth the reward, and started new businesses. These young firms are not limited to the construction startups, small law firms and accounting businesses, food trucks, and breweries that were brainstormed at the beginning of this article. While different startup costs, risk, and demand drive the number of startups in each industry differently, entrepreneurs are adding businesses and employment in every single industry. These entrepreneurs, their young businesses, and the new jobs they create are an important and significant part of Montana's economy.