

S e p t e m b e r
2002

ISSUE BRIEF

***Dark Cloud, Silver Lining:
Business Creation by
Dislocated Workers in Minnesota***

***Communications and Analysis Division
Analysis and Evaluation Office***

*Neal Young
Economic Analyst*

*500 Metro Square Building
121 7th Place East
Saint Paul, Minnesota 55101-2146
651-297-3548
www.dted.state.mn.us*



—Trade &—
**Economic
Development**

When workers are laid-off, they want to “get back on their feet” as quickly as possible. While most do so by finding employment with another company or organization, others decide to start their own business. A recent Minnesota Department of Trade and Economic Development (DTED) survey provides evidence that these new entrepreneurs are a potentially important mechanism in helping the state’s economy “get back on its feet” toward economic recovery. This issue brief documents the conditions during the 1990s that led to a relatively low rate of business start-ups in Minnesota and discusses a survey of laid-off workers and their efforts to start new businesses.

Minnesota Outpaced the United States During the 1990s. . .

Minnesota’s economy outperformed the national economy on a broad variety of economic measures between 1990 and 2000. The state had greater economic growth, greater employment growth, greater increases in per capita personal income and lower unemployment. And the accolades rolled in.

The Corporation for Enterprise Development (CFED) frequently named Minnesota to its “Development Report Card of the States Honor Roll” because of its economic performance. In fact, the honors extended beyond economic progress. From 1997 on, Minnesota has ranked as the “most livable state” in the United States for a record of six consecutive years, according to Morgan Quitno Press.

Except for Business Start-ups. . .

Growth in new businesses was one area in which Minnesota was not a national leader in the 1990s. CFED often pointed out that Minnesota ranked low in business start-ups. Despite high overall “grades,” which were mainly due to significant numbers of business expansions and low business failure rates, the state received B’s, C’s and D’s for entrepreneurial energy. A 2000 DTED report confirmed CFED findings, but also found that although there were fewer new businesses, those that did start were likely to expand and stay in business for the long term.¹

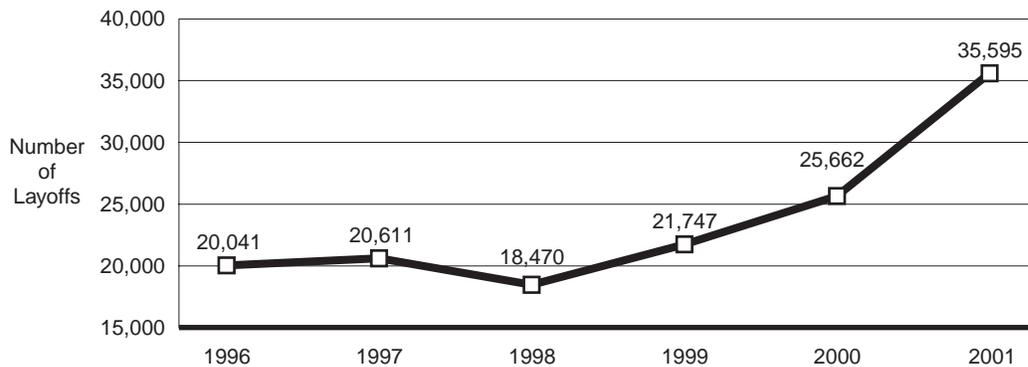
Business start-ups are desirable because of the entrepreneurial energy they create. Economies with greater numbers of new companies generally experience greater overall economic change, leading to the economic “churning” that is often recognized as a feature of successful economies. The creation of new businesses also tends to bring an economy closer to the cutting edge of new products and technologies. For these reasons, start-up businesses are often seen as desirable, and economies with low start-up rates may have cause for concern.

The Economic Downturn Left More People Unemployed. . .

The longest post-war economic expansion in U.S. history ended in March 2001, according to the National Bureau of Economic Research. However, even before then, unemployment in Minnesota was already on the rise. From the historically low unemployment rates of 1998 (including a seasonally adjusted low point of 2.4 percent in June through August), the unemployment rate began a slow, steady climb, reaching a seasonally adjusted peak of 4.4 percent in March 2002.² The number of unemployed people also rose significantly, as the seasonally adjusted number of people unemployed rose from 64,000 in July 1998 to a peak of nearly 125,000 people unemployed in March 2002.

Mass layoff events involving at least 50 workers were an increasingly important cause of unemployment during this period. Between 1996 and 1999, the total number of people involved in mass layoffs in Minnesota was approximately 20,000 per year (within a range of 2,000 layoffs). However, there were nearly 26,000 layoffs in 2000 and nearly 36,000 layoffs in 2001.³

Chart 1: Workers Unemployed Due To Mass Layoffs in Minnesota, 1996-2001



Source: U.S. Department of Labor, Bureau of Labor Statistics.

Many Who Wanted To Start A Business. . .

Research on the relationship between unemployment and business start-ups has generally shown a positive relationship, but with a twist. Often, an increase in unemployment over time in a particular geographic area is associated with an increase in business start-ups.⁴ Yet, when several geographic areas are compared to each other, areas with higher unemployment typically have fewer business start-ups. These results have led to a “push-pull” theory of the relationships between unemployment and business start-ups.⁵ On one hand, people are “pushed” into starting a business as an increase in unemployment leads people to take risks they would not take if employed. On the other hand, generally high unemployment levels stunt the business climate, “pulling” the unemployed back from starting a business.

As with any economic effect, this can be considered an issue of supply of and demand for a scarce resource, in this case entrepreneurs. The critical difference between the “push” effect and the “pull” effect is whether there is an increase in the supply of highly-skilled workers interested in starting a business. In areas with persistently high unemployment, there is no supply increase, as the

“push” effect may not be as strong as the “pull” effect. On the other hand, when skilled workers are laid-off in areas without persistent unemployment, the “push” effect may be stronger than the “pull” effect. Prominent local examples of workers “pushed” into entrepreneurship include businesses started by former IBM employees in Rochester in the early 1990s and former ADC employees in the metro area in recent years.⁶

Various forms of assistance provided to unemployed workers interested in starting a business can also contribute to the “push” effect. During the early 1980s, several European countries experimented with providing lump sum unemployment compensation as seed capital for starting a business. The U.S. Department of Labor also studied pilot programs in Washington and Massachusetts. The study found that when unemployed workers were provided self-employment assistance, they were more likely to be self-employed, to spend more time in employment, and to spend less time in unemployment than workers who received no such assistance.⁷

Which Resulted In New Businesses For Minnesota. . .

DTED conducted a short survey of Minnesotans who came in contact with DTED’s Dislocated Worker Program (DWP) during 2001, and who expressed an interest in starting a business. DWP provides training and employment services to Minnesotans who are or about to become unemployed due to mass layoffs. DWP collects information on these workers through a survey administered to workers enrolled in the program.

Data was available for 5,420 people from 51 projects. Data was not available in cases where workers did not fill out surveys or surveys for their project were unavailable. Of those for which data was available, 631 people (or 11.6 percent) indicated an interest in starting a business.⁸ DTED surveyed 573 people with valid addresses, receiving responses from 158 participants, a response rate of 27.6 percent.

The results of the survey are included in Table 1. Approximately 11.4 percent of respondents started a business that was still in operation at the time of the survey. Another 17.7 percent of respondents were in the process of starting a business and actively pursuing the option. The largest individual group consisted of respondents who were still considering starting a business,

comprising 39.9 percent of the total. The results clearly show that some laid-off workers are starting new businesses, and that many others remained either interested or actively involved in starting a business.

These results may seem insignificant until they are applied to larger populations than the survey respondents. If 11.4 percent of all 573 people interested in starting a business did so, there would be 65 additional new businesses in Minnesota. If the increase in mass layoffs between 2000 and 2001 (approximately 10,000 people) started a business at the same rate as the 2001 DWP participants (65 out of 5,420, or 1.2 percent), there would be an additional 120 new businesses in Minnesota.

Recent DTED studies on business start-ups have typically shown that Minnesota has gained approximately 12,000 new businesses annually in recent years. As such, an increase of 120 businesses would be an increase of about one percent in the number of business start-ups. In addition, other dislocated workers are continuing the process of starting a business, while still others are contemplating the jump into entrepreneurship.

Table 1: Business Activity of Dislocated Workers in Minnesota, 2001

<i>Where are you in the process of starting a business?</i>	<i>Number</i>	<i>Percent</i>
No longer considering starting a business	37	23.4%
Still considering starting a business	63	39.9
In the process of starting a business	28	17.7
Started process, but decided not to start a business	4	2.5
Started a business and continue to operate it	18	11.4
Started a business but sold it	0	0.0
Started a business but ceased operations	2	1.3
Other	6	3.8
Total Number of Responses	158	100.0%

Note: Statistical testing found no evidence that the pattern of responses and non-responses differed from the expected pattern of responses and non-responses that would be created by a representative sample.

Source: Minnesota Department of Trade and Economic Development, Analysis and Evaluation Office.

Table 2: Estimates of Business Start-ups by Workers Involved in Mass Layoffs, 2001

<i>Where are you in the process of starting a business?</i>	<i>Estimate</i>
No longer considering starting a business	881
Still considering starting a business	1,500
In the process of starting a business	667
Started process, but decided not to start a business	95
Started a business and continue to operate it	429
Started a business but sold it	0
Started a business but ceased operations	48
Other	143
Total Number of People Interested In Starting a Business	3,763

Note: These estimates were generated by applying the proportions found in the survey to the 35,595 workers unemployed due to mass layoffs in 2001.
Source: Minnesota Department of Trade and Economic Development, Analysis and Evaluation Office.

According to DWP experts, these estimates could be conservative. Eligible laid-off workers who choose not to enroll or seek DWP assistance may be more inclined to start a business because DWP services have historically been most attractive to workers seeking re-employment assistance. Therefore, applying the survey results to the total number of workers involved in mass layoffs should generate a conservative estimate of the number of businesses started by laid-off workers in 2001.

Table 2 includes estimates that suggest that workers involved in mass layoffs started more than 400 businesses—or over 3 percent of all business start-ups—in 2001. Moreover, nearly 700 of these workers are estimated to be in the process of starting a business, while about 1,500 workers are estimated to be considering starting a business. The last two categories are important, as they indicate that workers unemployed due to mass layoffs in 2001 may create additional new businesses beyond those reported here.

These new businesses are important, especially in rural areas. New businesses create the entrepreneurial energy, as well as the employment alternatives, that keep an economy thriving in the long-term, despite short-term economic downturns.

Actual Experiences of Dislocated Entrepreneurs. . .

Follow-up discussions with two dislocated workers turned entrepreneurs from the survey proved illustrative. Phil Springstead started Concept Art for Sciences, Inc. after being laid off at Honeywell. The company develops graphic representations of concepts that become inventions. Springstead mentioned that he enjoyed his job at Honeywell very much. In fact, his job satisfaction led him to start his own company after his layoff because he didn't want to switch fields. The company is the second venture for Springstead, though it is his first full-time attempt at running a business (he also restores antique oil paintings in his spare time).

Kurt Thielen of SoniqCast had never started a business, but had always been interested in doing so. When he was laid off from Tellabs, he started a company that will manufacture consumer electronics after completing the design and development phase. Both Springstead and Thielen said that they would not have started their business had they not been laid off. According to Thielen, “the problem with having a good job is that you never want to quit and start your own business. It's too much of a risk.”

Policy Implications. . .

The survey of dislocated workers interested in starting a business coupled with subsequent interviews with entrepreneurs revealed a potential source of entrepreneurial energy and business start-ups. The key policy discussion is how best to nurture budding entrepreneurs among the unemployed and lead them into the process of starting a business. Minnesota's relatively low business start-up rate clearly suggests that Minnesota needs to support a culture that encourages and values entrepreneurship. At least four key types of support can contribute in this regard:

- **Recognition:** Starting a business should be recognized as a viable option for workers who are laid off or otherwise unemployed. People sometimes view starting a business as continued unemployment because the entrepreneur has not returned to wage employment. From this perspective, an entrepreneur is viewed as a failure, rather than as a potential success.
- **Information:** Although DTED's Small Business Assistance Office and other organizations currently provide various small business resources to dislocated workers, these resources could be enhanced to further support entrepreneurs. A good example of how resources are being enhanced is the Virtual Entrepreneurial Network.
- **Training:** The Dislocated Worker Program encourages participants with interest in starting a business to receive training in the entrepreneurial process and in various skills critical to the success of small businesses. DWP-eligible workers interested in starting a business could benefit from these resources.

- **Assistance:** The Small Business Development Center network and Minnesota Project Innovation are among the many state and federal services that offer technical and/or financial assistance to small businesses. These resources could be targeted at potential entrepreneurs who were laid off from their previous employment. Additional research would be helpful to determine how well current forms of assistance meet the needs of these entrepreneurs.

All of these types of support are currently provided in varying degrees to dislocated workers interested in starting a business. However, more can be done in these and other areas to enhance the likelihood of successful start-ups in Minnesota.

A first step may be to track the businesses discovered in the survey and other businesses created under similar conditions to see if the survival rate is higher than for other businesses. It would also be useful to examine the funding sources of such entrepreneurs. Such studies may reveal opportunities to improve the climate for such businesses, including unconventional approaches like the self-employment assistance provided to unemployed entrepreneurs in Washington and Massachusetts.

This issue brief has presented a potential opportunity in creating a culture that values and encourages entrepreneurship. How government, community and business leaders respond to this challenge will play a critical role in Minnesota's future economic health.

Endnotes:

- (1) Venegas, Ernesto C. "Start-ups and Expansions Fuel Minnesota's Economic Engine." Minnesota Department of Trade and Economic Development.
- (2) Local Area Unemployment Statistics (LAUS), Minnesota Department of Economic Security.
- (3) Mass Layoff Statistics (MLS), U.S. Department of Labor, Bureau of Labor Statistics.
- (4) Hamilton, R.T. "Unemployment and Business Formation Rates: reconciling time-series and cross-section evidence." *Environment and Planning A*. Vol. 21 (1989), pp. 249-55.
- (5) Tervo, Hannu and Hannu Niittykangas. "The impact of unemployment on new firm foundation in Finland." *International Small Business Journal*. Vol. 13 (1994), no. 1, pp. 38.
- (6) Page, Heather. "Executive Decision." *Entrepreneur*. Vol. 24 (1996), no. 7, pp. 148. (See also: Reilly, Mark. "ADC refugees seeding start-ups." *CityBusiness*. Vol. 19 (2001), no. 10, pp. 1.)
- (7) "Self-Employment Programs: A New Reemployment Strategy, Final Report on the UI Self-Employment Demonstration." U.S. Department of Labor, Employment and Training Administration. Unemployment Insurance Occasional Paper 95-4.
- (8) To be included, a project must have had a project start date during calendar year 2001 and available Rapid Response survey forms (necessary for contact information). The total number of people and the number of people interested in starting a business came from the Rapid Response survey database.

The Minnesota Department of Trade and Economic Development is the state's principal economic development agency. The mission of the department is to employ all available state government resources to facilitate an economic environment that produces net new job growth in excess of the national average and to increase non-resident and resident tourism revenues.

The department includes:

Minnesota Trade Office

The Minnesota Trade Office (MTO) is the export and foreign investment development division for the state. It provides information, education, counseling and financial services to Minnesota businesses. The MTO's principal goal is to promote, facilitate and deliver international business export assistance and services to Minnesota businesses.

Business and Community Development Division

The Business and Community Development Division provides a variety of financial and technical services to businesses, communities and economic development professionals. This division administers programs which provide business financing, technical assistance, location assistance, capacity building and infrastructure financing.

Minnesota Office of Tourism

The Minnesota Office of Tourism promotes the state's tourism industry to increase non-resident and resident tourism revenues. It markets Minnesota's products and services related to travel, conducts organizational partnerships, and provides information to travelers. The office generates travel to and tourism within the state and supports the state's communities and tourism industry.

Workforce Development Division

The Workforce Development Division provides training and support services to unemployed and dislocated workers; financial assistance for businesses seeking to upgrade worker skills; grants to help ease a shortage of workers in the health and human services industry; and short-term, no interest loans to businesses for training new or existing employees.

Communications and Analysis Division

The Communications and Analysis Division supports department activities through centralized communications, marketing, research, analysis and program evaluation services. Recent publications include *Compare Minnesota*, *Positively Minnesota*, *2001 Progress Report* and *Minnesota: World Competitor*. Recently-completed research covers a wide range of topics including the effects of mergers and acquisitions on the state's economy, the biotech industry, business start-ups, business subsidies, exporter needs, travel and tourism trends, and dislocated workers-turned entrepreneurs. The division also maintains the department's web site.

