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Economic and Social Crises and the Power of Data

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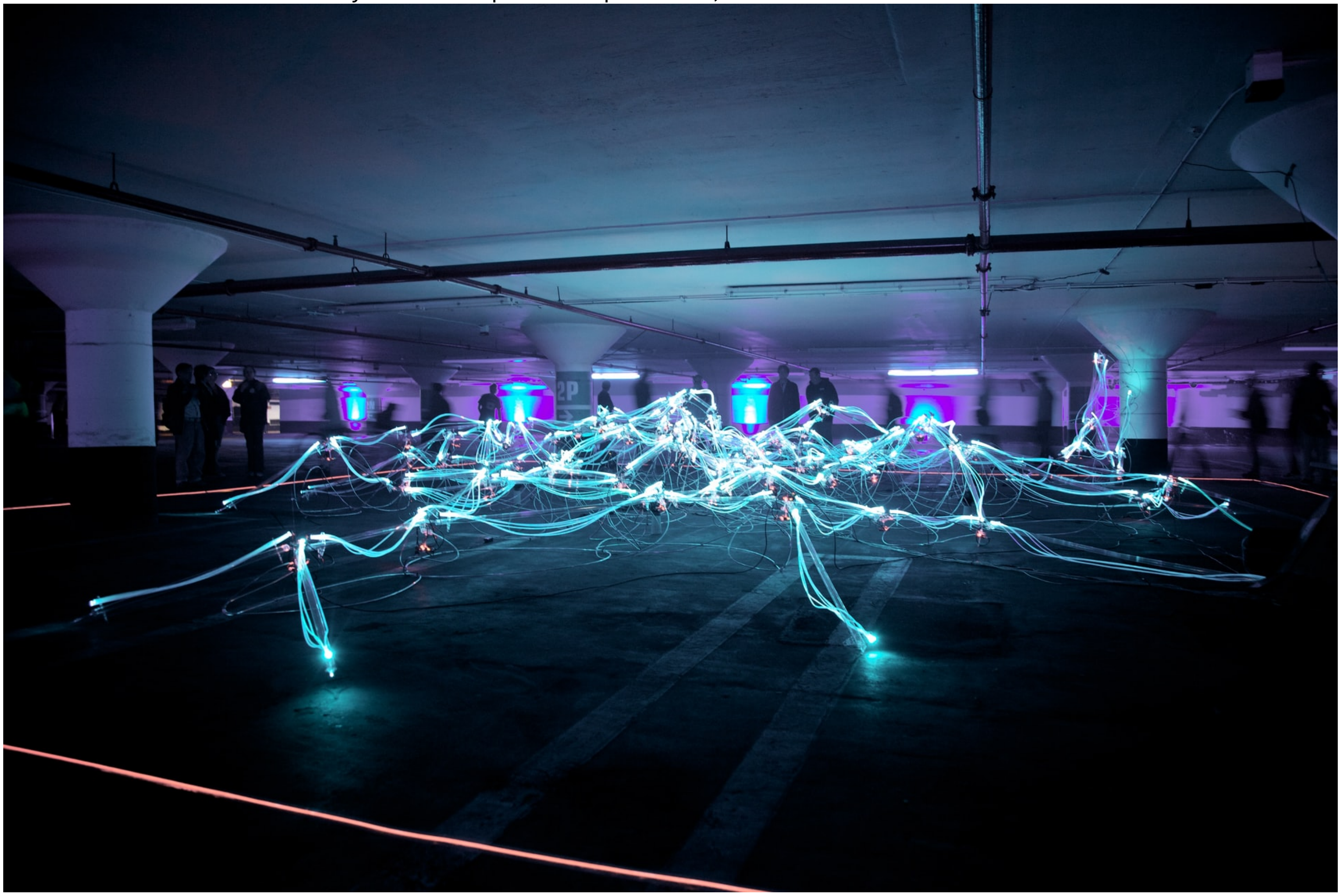


How Entrepreneurship can be part of economic revival

In 2020, a social crisis, unprecedented in our modern society for its rapid and wholesale impact, descended upon the World, inflicting its force in nearly every corner of the globe, causing widespread loss of life and threatening the economic welfare of every community. We might have rationally thought that advances in medicine, technology, and communication would make us immune to an out-of-control virus. Perhaps we should be able to control the outbreak of a disease, no matter how aggressive. But the COVID-19 pandemic has taught us that much of this control is in retrospect, when we realize how extensively we were caught off guard, how we didn't act when we should have. No longer able to anticipate and pre-empt, we can only react, taking the knowledge we have and amassing our understanding to minimize further social and economic damage. It was too early, in the spring of 2020, to think about the lessons we would take forward, but there will be lessons.

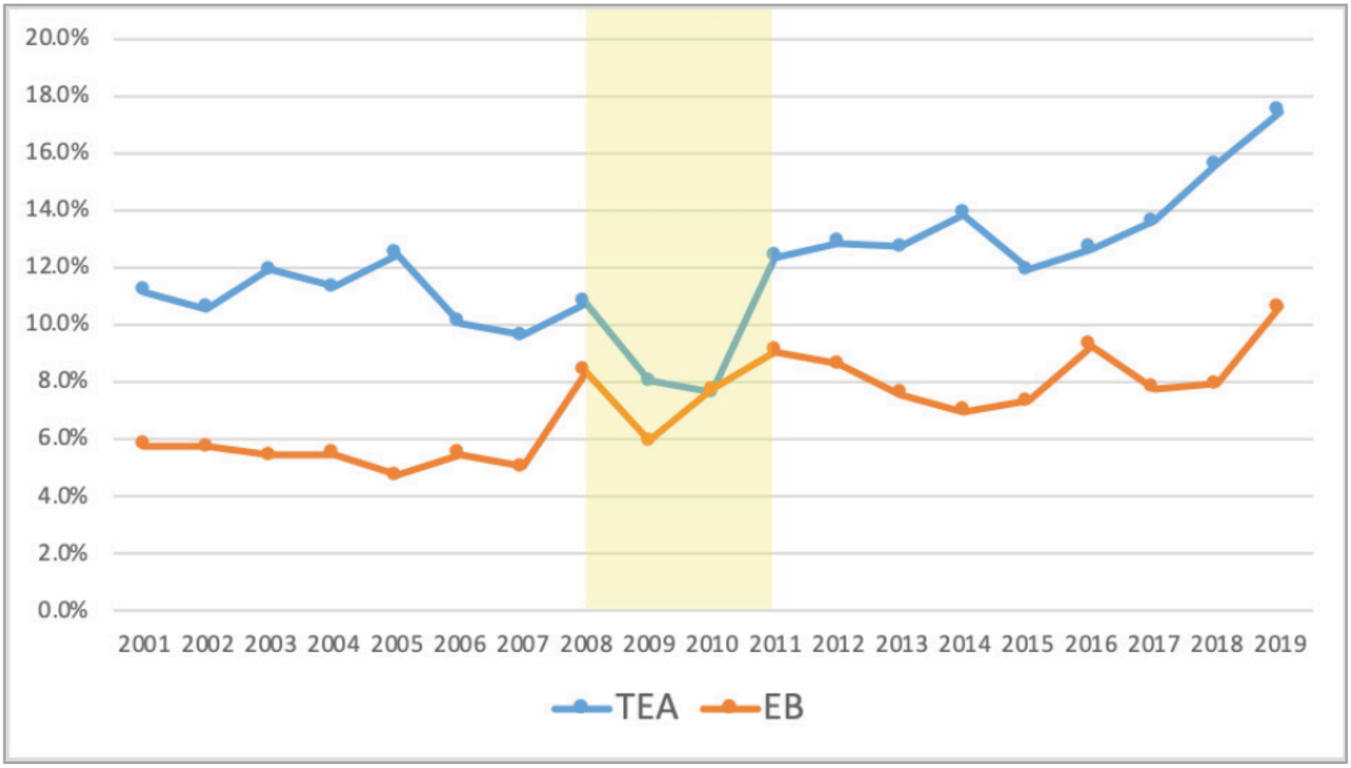
The social and economic costs of the COVID-19 pandemic have been viewed, by some, as tradeoffs. Do we accept some deaths as perhaps inevitable or, at the very least, a cost we must endure to avoid the economic consequences? Or do we avoid human loss at all costs, particularly when it is a family member, close friend, or a medical professional that risked their life to save others? Fundamentally, though, we recognize that we cannot have a functioning economy with an unrestrained health crisis. Nonetheless, we have to fight the social battle with all our might while recognizing that the economic fallout could have devastating results for society. Recognizing that entrepreneurs and business owners are critical to the functioning of every economy, most policy makers realize that small business has to be part of this conversation.

There is no shortage of predictive models to guide our evolving understanding and actions around this pandemic. These models draw on past events and current data collection to make assumptions and draw up scenarios for us to contemplate. A number of surveys have provided timely insights on the impact of COVID on businesses among members of various associations or within communities or regions. At a worldwide level, the Global Entrepreneurship Monitor (GEM) revised its 2020 survey to include questions related to the pandemic. This will provide internationally comparable, representative data about the impact of COVID-19 on entrepreneurs and business owners. GEM also has data reaching back to 1999 that can provide historical insights. For example, the 2008 global recession can help us understand what we are currently experiencing. At the very least, we can debate what lessons we can apply from the recession, and in what ways the current crisis differs from the financially-driven one in our past.

In the United States, where the 2008 recession originated, entrepreneurship experienced a decline at the end of the recession. As Figure 1 shows, Total Entrepreneurial Activity (TEA) rates were between ten and twelve percent of the U.S. population from 2001 to 2008. This rate dropped below 8% in 2009 and 2010 as markets for new goods and services and investment capital contracted in a risk averse environment. This risk aversion can be seen in GEM's societal attitude measure of fear of failure, which increased in 2009, and then continued increasing through 2012, when nearly one-third of those seeing opportunities around them for starting a business would not do so because of the chance it might fail. The impact on entrepreneurship observed in the United States after the recession is not a special case. Very similar drops were observed in other countries around the world—e.g., China, Japan, Australia, Spain and Italy.

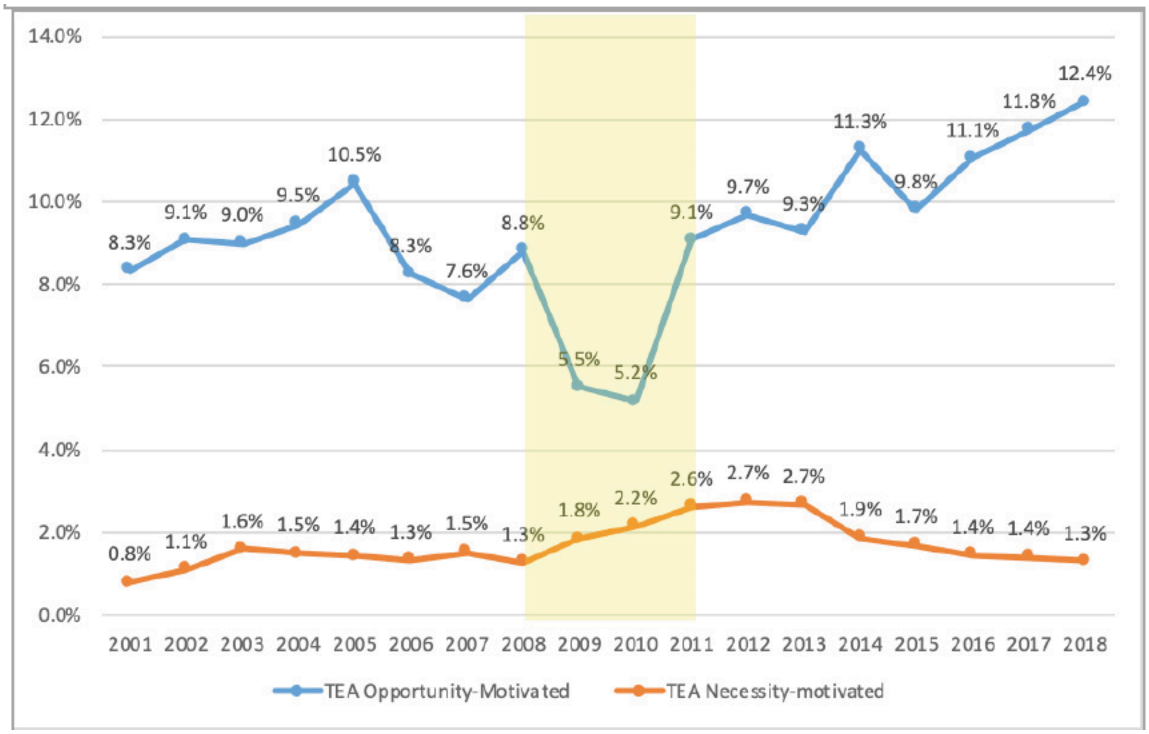
Established business ownership (the percentage of adults owning and managing businesses three and a half years old or older) also declined in 2009, but seemed to bounce back the next year, likely reflecting prior high TEA rates. However, this indicator started a three-year decline in 2012, three years after TEA rates first dropped. Together, these two indicators show the lasting impact of economic downturns across phases of business ownership activity.

Figure 1. Total Entrepreneurial Activity (TEA) and Established Business (EB) Ownership Rates in the U.S. Adult Population (18-64 years). GEM 2001-2019.



The 2008 recession's impact on entrepreneurship was not just simply a case of fewer people starting businesses. As Figure 2 demonstrates, more people were starting out of necessity in 2009 than the prior eight years and this continued to increase through 2012. In 2010, necessity accounted for the startup motives of nearly 30% of entrepreneurs. Thus, the drop in entrepreneurship in 2009 and 2010 was entirely due to fewer opportunity-motivated entrepreneurs. People might have forgone or delayed the pursuit of opportunities, given the less-favorable context and perhaps choosing to stay with more stable employment. On the other hand, the higher incidence of necessity entrepreneurship shows how this can help those in need of income, and with few job prospects.

Figure 2. Opportunity-Motivated and Necessity-Motivated Total Entrepreneurial Activity Rates in the Adult U.S. Population (18-64 years). GEM 2001-2018



Another trend just after the recession can be seen in the percentage of entrepreneurs starting in the medium or high technology sectors. Despite all the visibility and attention they receive, only a small minority of entrepreneurs are starting technology businesses—generally around 7% in the United States. However, in 2010, as TEA bottomed out, none of the entrepreneurs interviewed indicated they were starting technology businesses.

In sum, these results indicate that the 2008 recession led to a decline in entrepreneurship rates, but particularly among opportunity-driven entrepreneurs, and also showing an impact on technology sectors. Yet what is also evident in the two figures is that all of this bounced back. In 2011, TEA rates jumped 60% from the prior year and have since increased to the highest level reported in GEM's 21-year history. Established business rates exhibited a lag effect where declines came several year after the drop in TEA. But like TEA, these rates have since reached an all-time high in 2019. Additionally, necessity entrepreneurship has returned to its low levels and participation in technology sectors rebounded. In contrast, while fear of failure eventually started to taper downward in 2013, it started to edge upward since 2015, perhaps affected by opportunity costs associated with the availability of jobs as unemployment fell to historic lows.

While predicting the economic effect of COVID-19 with any precision may seem an impossible task, it may be useful to examine data that can help us understand the potential impact, particularly the long-term impact, on entrepreneurship and small business. The nature and magnitude of the COVID recession, however, differs greatly from the 2008 recession. Although the 2008 recession had widespread and lasting effects around the world, the COVID recession is considered unmatched since the Great Depression of the 1930s.

By the end of May 2020, nearly 30 million people in the United States filed unemployment claims. A National Bureau of Economic Research (NBER) working paper, reporting on a survey of more than 10,000 people, found that 50% of respondents reported income and wealth losses. Consumer spending dropped 31%, particularly in travel and clothing.[1] The IMF, among others, suggested that the economic impact could be long-lasting, perhaps decades.[2] Not inconsequential in contributing to this effect is the uncertainty with respect to customer behavior: will people flood back to restaurants and spend as they did before the crises? Or will there be some permanence in the changes we see in society: frugal customers jarred by the impact COVID had on so many dimensions of their lives, hesitancy about venturing into venues with large crowds, continuing behaviors established during the crisis, such as online shopping, watching movies at home, or working remotely?

Any behavioral changes will surely have a long-term effect on entrepreneurship and small business. Some businesses were already struggling when the pandemic hit, others will likely see their businesses become less viable in a changed environment. Yet change brings opportunity and those able to adapt or capitalize on opportunities can thrive.

Another NBER survey, of more than 5,800 small businesses, reported that 43% of business had temporarily closed, with hospitality, retail, personal services, entertainment and the arts more negatively affected. Additionally, businesses with fewer than 20 employees were more likely to be closed or experience the highest employment reductions. Three-quarters of those responding said their businesses only had enough cash to cover expenses for two months or less.[3]

When we look around us, in our own communities, we see businesses that have been ordered closed—hair salons, pubs, hotels. On the other hand, some have been able to adapt—for example, restaurants offering takeout, health clubs offering online fitness classes, producers shifting to products or services needed during the crisis. But some businesses are thriving—such as bicycle shops for people who are getting outside to escape the boredom of house confinement, food markets and liquor stores for people who are not going out to eat or drink.

Like the 2008 recession, we will see a decline in entrepreneurship rates in many economies. A shift toward necessity motives will likely take place as those losing their jobs seek to generate their own source of income. Technology will make it easier and cheaper to get something up and running, and the expanding gig and sharing economy will enable people to fill in income gaps temporarily. The fallout will occur in the smallest businesses, those unable to sustain their operations during a shutdown that lasted longer than most expected, and that were either forced to temporarily close or that suffered from a drop in demand.

But this effect will depend on the type of business. Any recession produces a drop in discretionary spending, affecting businesses in entertainment, arts, recreation, travel and the like. The COVID recession, however, was driven by a social crisis that produced impacts beyond one’s financial situation, imposing widespread effects on the health and behavior of people around the world. It can be imagined that the consequences will be more uneven and unpredictable across the business community.

Governments are stepping in to provide relief funds for businesses, such as the nearly $700 billion the U.S. government approved for small businesses through their Paycheck Protection Program (PPP). At the time of this writing, though, in June, it is still unknown how long the shutdown will last, how long it will take to get back to business as usual, if that is possible, and whether there might be a resurgence down the road. For some businesses, getting funds to get through this crisis temporarily may only prolong the inevitable.

For prospective entrepreneurs that are holding back their pursuit of opportunities, the question is when they will judge the environment attractive enough and sufficiently stable to launch their businesses. Interestingly, from dedicated questions inserted into the 2009 and 2010 GEM study, it was found that 22% of early-stage entrepreneurs in the United States actually identified new opportunities emerging from the crisis. This percentage compares rather well across the globe, which signals that, to some extent, every society hosts individuals who are keen on pursuing new ideas in challenging and changing environments. At the same time, the results showed slightly different responses, which can probably be linked to the local economic and cultural context. For example, in Italy and Spain, both heavily affected by the crisis, the rate of opportunity identification was around 15%, while it was 19% and 24% in the United Kingdom and Germany, respectively.

These opportunity - identifying entrepreneurs form a breeding ground out of which novel ideas and new businesses can emerge, even amid a financial crisis. For example, some well-known ventures were launched during 2008 and 2009, including Groupon, Uber, WhatsApp, Slack, Venmo and AirBnB, to name a few. Entrepreneurs who are able to capitalize on the changes taking place will find markets, and perhaps other advantages such as less competition, better lease terms, lower interest rates, and qualified employees. Society will benefit from those who, for whatever reason, are bold enough to act on opportunities.

While the entire social and economic impact of COVID-19 has not been fully felt as of June 2020, many are relying on historical and real-time data to predict its impact. The response of the public and private sector cannot wait for results to unfold. Each nation, state, and municipality must take steps to best protect the health and wellbeing of its people, before the effects of COVID-19 are completely known. Past data can be most useful when examined in light of the unique characteristics of the current situation. And as data collection continues, it will be important to analyze results to advance our understanding and apply the lessons gained toward a more prepared and stable future.

The entrepreneurship sector plays a key role in helping us withstand and recover from crises. Societies around the world rely on the jobs, and the products and services, entrepreneurs create. It is apparent that entrepreneurship is, and will be, affected by COVID-19 in particular ways not seen in our history. However, we can look at past data to assess the effect on the rate and quality of entrepreneurial activity imposed by events that shock and alter our world. We know that the financial crisis of 2008 negatively impacted entrepreneurship, but entrepreneurship emerged strongly to aid in the economic rebound. While the speed and nature of the recovery from COVID-19 is far from certain, dependent at least in part on medical discoveries, human behavior, and the actions of government, we can look to entrepreneurship to be part of this revival.

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[1] **https://www.nber.org/papers/w27141**

[2] **https://www.imf.org/external/pubs/ft/fandd/2020/06/pdf/fd0620.pdf**

[3] **https://www.nber.org/papers/w26989.pdf**

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This ICSB Gazette issue is featuring an article written by Donna Kelley

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