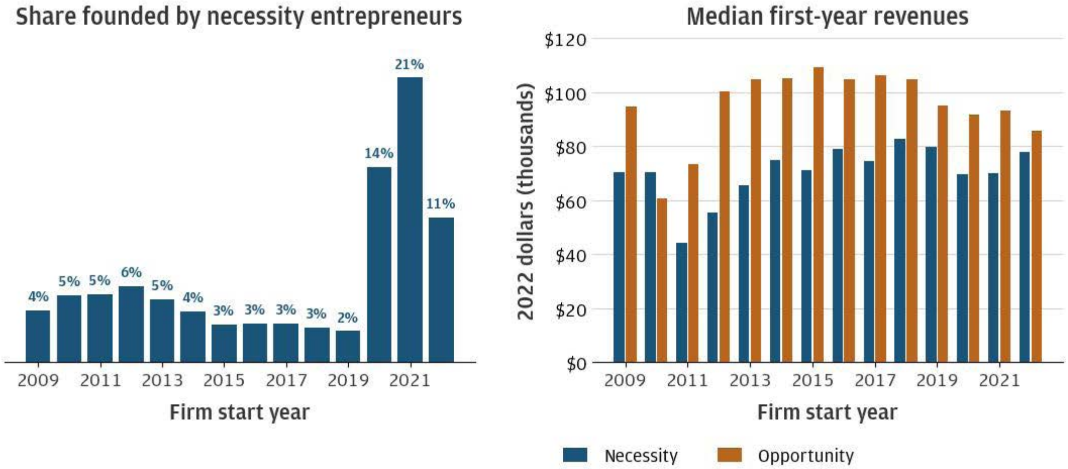
When opportunity knocks: How economic cycles shape entrepreneurial ventures and their success

After a decades-long downward trend in business dynamism, a surge in new business applications during the COVID-19 pandemic stirred cautious optimism for future economic growth. Over 545,000 new business applications were filed in July 2020, nearly twice the level 12 months earlier1. In the past few years, entrepreneurs founding new businesses did so under unique economic and labor market conditions, which may have affected their prospects.

When material shares of new businesses are founded out of necessity, subsequent economic growth may be muted. Moreover, the potential for necessity entrepreneurship to reduce inequality or build wealth may be limited.

In an accompanying report, we found that although women were not more likely to be necessity entrepreneurs, the gender revenue gap persists among both necessity and opportunity entrepreneurs.

A large share of businesses founded after the onset of COVID were started out of necessity, had lower revenues, and were more likely to exit



Note: Sample included small businesses opened in each year that were active within the first 12 months. Necessity entrepreneurs were business owners who received unemployment insurance within the 12 months prior to opening their businesses.

Source: JPMorganChase Institute

Findings:

1. **In economic downturns, necessity entrepreneurs start a larger share of new firms.** Economic growth resulting from the surge of new firms during the pandemic may be muted.
2. **Necessity entrepreneurs founded increasing shares of restaurant, retail, and personal services businesses after the onset of COVID.** Necessity entrepreneurs started firms in distressed industries during the pandemic, which could affect their business prospects.
3. **In recent years, necessity entrepreneurs were more likely to be under 35 and non-White.** Necessity entrepreneurship reflects labor market conditions.
4. **Firms started out of necessity had lower initial revenues, but the revenue gap between opportunity and necessity entrepreneurs narrowed during the pandemic.** Necessity entrepreneurship may not reduce inequality in financial outcomes.
5. **Necessity entrepreneurs were more likely to exit within 2 years, and the difference was largest among Black business owners.** Necessity entrepreneurs may prefer wage employment and exit self-employment when possible.

Implications:

- **The motivations of entrepreneurs and economic conditions in which they start their firms may affect their subsequent contributions to aggregate economic growth.** Firms started by necessity entrepreneurs or during economic downturns may have limited resources, possibly affecting growth intentions as well as actual growth. When a sizable share of new businesses is founded by necessity entrepreneurs or in a weak economy, as in the pandemic, the contribution to aggregate economic growth may be muted.
- **Firms started by other types of necessity entrepreneurs—such as recent immigrants or returning citizens—may face similar challenges as those founded after involuntary unemployment.** In this report, we defined necessity entrepreneurs as those who received UI in the year before opening their business. While this definition was tractable and could be consistently applied across a large dataset, it excluded other types of necessity entrepreneurs. However, insights from this report may nevertheless apply to other types of necessity entrepreneurs, especially those who are disadvantaged in traditional labor markets.
- **Necessity entrepreneurship may not reduce inequality in financial outcomes.** Entrepreneurship is sometimes promoted as a potential mechanism for addressing inequality: those disadvantaged in traditional labor markets can become entrepreneurs, earning income and building wealth for themselves and their families, thereby reducing inequality in financial outcomes. However, racial and gender gaps in business outcomes and capital access are well-documented. If Black, Hispanic and Latino, or women business owners are also more likely to be necessity entrepreneurs, then their businesses may not achieve the growth needed to materially reduce inequality or build wealth.
- **Policies that support entrepreneurship as a viable alternative to wage employment can benefit both business dynamism and labor market fluidity.** In economic downturns, some unemployed workers turn to self-employment. For some, it is a temporary solution until labor market conditions improve, but for others, it may be the beginning of a new career. For potential entrepreneurs, the availability of affordable health insurance as well as unemployment insurance in the event their ventures fail are important considerations in entering and leaving self-employment. A well-functioning labor market should include viable options for entrepreneurship.

Data explanation:

The figure consists of two panels displaying bar charts. The left panel features one bar for every year from 2009 through 2022, that shows the share of firms opened in each year that were founded by necessity entrepreneurs. The share rises from 4 percent in 2009 to 6 percent in 2012, declines to 2 percent in 2019, jumps to 14 percent in 2020 and 21 percent in 2021 before falling to 11 percent in 2022. The right panel presents the median first-year revenues of the firms started in each year from 2009 through 2022. The chart has two bars per year representing firms founded by necessity and opportunity entrepreneurs. The bars representing medians among firms founded by opportunity entrepreneurs are higher than those representing medians among firms founded by necessity entrepreneurs in every year.

Suggested citation:

Wheat, Chris and Chi Mac. 2024. "When opportunity knocks: How economic cycles shape entrepreneurial ventures and their success." JPMorganChase Institute. https://www.jpmorganchase.com/institute/all-topics/business-growth-and-entrepreneurship/when-opportunity-knocks-how-economic-cycles-shape-entrepreneurial-ventures-and-their-success

Endnotes:

1. The Census Bureau's Business Application Series is available through https://fred.stlouisfed.org/series/BABATOTALSAUS.

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