

To create jobs, nurture start-ups

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MODERN tools of data analysis — fast computers, smart software and vast troves of digital information — often open the door to new insights. Consider the subject of jobs in America.

For decades, the assumption has been that small business is the economy's dynamic engine of job generation. Look at the numbers broadly, and that is the irrefutable conclusion: two-thirds of net new jobs are created by companies with fewer than 500 employees, which is the government's definition of a small business.

But research published last month by three economists, working with more recent and detailed data sets than before, has found that once the age of the businesses is taken into account, there is no difference in the job-producing performance of small companies and big ones.

"Size plays virtually no role," says John C. Haltiwanger, a co-author of the study and an economist at the University of Maryland. "It's all age — start-ups are where the job-creation action really occurs."

Start-ups account for much job destruction as well. Within five years, half of these businesses have folded. Yet the survivors are prime candidates to join the young, dynamic companies that make an outsize contribution to innovation, productivity gains and job growth, Mr. Haltiwanger says.

So any serious discussion of job creation, it seems, should look at the business tactics and policy steps that are most likely to nurture more of these promising corporate upstarts.

Doing that can be tricky, however, and government small-business initiatives are often misguided, according to Josh Lerner, a professor at the Harvard Business School. Government programs to stimulate bank lending, he says, are not geared to entrepreneurial start-ups. Those new companies need equity investment to fund risk-taking, free of the financial burden of paying interest on loans.

Mr. Lerner is concerned about the impact of the Obama administration's plan to raise the tax on long-term capital gains — profits on investments held more than a year — to 20 percent from 15 percent for taxpayers with household incomes of at least \$250,000. It could well reduce early-stage equity funding by angel investors, typically individuals who provide the seed capital for new companies well before venture capital firms put in money.

"Capital gains taxes are an important part of the calculus of angel investors," he said.

For the small-business sector as a whole, individual income tax rates are an important issue, and small-business lobbying groups are fighting the administration's proposal to raise the top rate to 39.6 percent from the current 35 percent.

Yet that is not the perspective of start-ups. Most young companies make precious little income during their first few years, and their leaders are focused on hitting it big, not on tax rates. In the 1970s, for example, when Bill Gates and Steve Jobs founded their companies, the top income tax rate was 70 percent.

"For entrepreneurs, the marginal income tax rate doesn't make any difference," says David Friend, 61, a founder of six companies over the last three decades.

Today, Mr. Friend is the chief executive of Carbonite, a five-year-old technology company based in Boston. It grew out of the observation that few people make backup copies of digital

photographs, personal records and documents that they have stored on their computers — and often lose them if a hard disk crashes or a notebook machine is lost or stolen.

So Mr. Friend and his co-founders set out to build an easy-to-use online backup service for consumers and small businesses. It stores their information remotely and offers unlimited storage for \$55 a year.

Carbonite's revenue is doubling annually, to an estimated \$40 million this year, Mr. Friend says. Its employment in the United States, largely engineers and marketing staff, has more than tripled in the last two years, to 132.

For Barry Silbert, 34, start-up success has been a result of spotting a market opportunity and, then, deft execution. Five years ago, as a young investment banker, Mr. Silbert recognized the growth in restricted stock issued to corporate managers. This stock cannot be traded on public exchanges, so he wanted to set up a new marketplace to trade those shares.

Mr. Silbert began in a tiny office in New York City with five people, two telephones and a few desktop computers. Their trading technology consisted of Excel spreadsheets, he recalled. It was a "lean start-up" before that term was widely used.

"But that meant we were profitable almost from the start," says Mr. Silbert, the chief executive of the company, called SecondMarket. Today, SecondMarket is best known for dealing the private shares of fast-growing tech start-ups like Facebook, Twitter and LinkedIn. These companies have not yet gone public, but former employees and others often want to sell their shares.

SecondMarket is growing rapidly, he says, with revenue of \$35 million last year, and its work force has more than doubled in less than two years, to 150. It plans to expand abroad, in Asia and Israel.

For Mr. Silbert, work-force issues trump taxes as a long-term concern. Like many other entrepreneurs, he advocates granting more residence visas to skilled immigrants, especially those who attend American universities.

"The best and the brightest from other countries come here, and then we're not letting them stay," he said. "That will damage innovation and job creation in the United States."

FOREIGN-BORN entrepreneurs have long played a big role in American start-ups. A study that tracked technology and engineering start-ups from 1995 to 2005 found that one quarter of them had a foreign-born chief executive or head technologist; by 2005, the surviving companies generated \$52 billion in sales and employed 450,000 workers.

There are signs that policy makers are looking to accommodate highly skilled workers and entrepreneurs, says Robert Litan, an economist at the Kauffman Foundation. As one example, he points to legislation proposed this year by Senators John Kerry, Democrat of Massachusetts, and Richard G. Lugar, Republican of Indiana. Called the Start-Up Visa Act, it would grant visas to immigrant entrepreneurs who create jobs in the United States.

"In this economic environment, I think job-creating ideas that don't cost money are going to get a fair hearing," Mr. Litan says.

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