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Entrepreneurship in Silicon Valley During the Boom and Bust

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Purpose

The purpose of this study is to understand the impact of tight labor markets on the high-tech industry and its effect on entrepreneurship in Silicon Valley during the boom and bust. This report uses a new measure of entrepreneurial activity to study entrepreneurship from 1996 to 2005 in Silicon Valley known as "The Kauffman Index of Entrepreneurial Activity" (KIEA). This new measure captures the rate of business creation at the individual owner level.

Economic expansion in the late 1990s generated many opportunities for business creation and productivity growth, which has been mostly linked with investment in information and communication technologies. Regions with large concentration of high-tech industries in the San Francisco, San Jose, and especially the Silicon Valley area, placed emphasis on the role of startups and entrepreneurship. This period was set apart by swiftly rising stock prices, lucrative stock options, venture capital deals, initial public offerings, and tight labor markets. Consequently, it is unclear whether this was a period of heightened entrepreneurship or one in which returns to working in firms discouraged entrepreneurship.

This paper investigates the effects of tight labor markets on entrepreneurship activity in the Silicon Valley compared to California and the United States.

Overall Findings

The study finds that entrepreneurship rates in Silicon Valley were higher than in the rest of the United States during the expansion period of the late 1990s. During this time period, entrepreneurship rates increased in the Silicon Valley while the national rate remained constant. The study points out that entrepreneurship was higher after the dot com bust in Silicon Valley than during the boom period.

The findings indicate that demographic characteristics of the population and economic conditions are important at least in terms of potentially creating high rates of entrepreneurship. Silicon Valley entrepreneurship rates as a whole appear to have been suppressed by the extremely tight labor markets during this period.

Highlights

- High-tech industries appear to be important in contributing to high rates of entrepreneurship in Silicon Valley, but entrepreneurship in other industries comprises the bulk of total entrepreneurship in the area.
- The rest of California and several large metropolitan statistical areas had higher rates of entrepreneurship than Silicon Valley during the late 1990s.
- Controlling for differences in demographic characteristics, previous employment status, and industry concentrations, Silicon Valley had higher rates of entrepreneurship than the rest of the United States during the late 1990s.
- Residents of Silicon Valley are more likely to be immigrants and more highly educated than the rest of the United States, but are less likely to own homes and be unemployed, all of which are important determinants of business creation.
- Controlling for changes in demographic characteristics, unemployment, and industry composition, entrepreneurship rates in Silicon Valley increased by 0.034 percentage points from the late 1990s to the post-boom period relative to the trend in the U.S. entrepreneurship rate.

Data Sources

Entrepreneurship rates are estimated using microdata matched monthly files from the Current Population Survey (CPS) for the time period 1996–2005. The mid to late 1990s period has been chosen and defined as the economic boom period, and early 2000s to 2005 has been defined as the post-boom period.

Entrepreneurship rate is defined in this study as the percent of the population of non-business owners that start a business each month. This survey is conducted by the U.S. Bureau of the Census and the U.S. Bureau of Labor Statistics, and is representative of the U.S. population. Matching the monthly files allows for all new business owners both incorporated and unincorporated as well as those who are employers or non-employers to be captured. To estimate the entrepreneurship rate, all observations with allocated labor force status, class of worker, and hours worked variables are excluded from the sample.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the Director of Economic Research at **advocacy@sba.gov** or (202) 205-6533.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at **www.sba.gov/advo/research.** Copies are available for purchase from:

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