

MARKET COMMENTARY – SEPTEMBER 1, 2016

*“Le marchand de la mort est mort.”  
(The merchant of death is dead.)*

In 1888, Ludvig Nobel, a Swede, died while visiting Cannes. A French newspaper penned an obituary railing against his life’s work. The catchy line above and other zingers from the article were oft-repeated. Unfortunately, the fellow denounced by the paper was Ludvig’s brother and still very much alive. The tale goes that upon seeing such a harshly critical obituary of his life, Alfred Nobel, the inventor of dynamite and holder of hundreds of other patents, used his self-made fortune to establish the Nobel Prize.

We were reminded of the hasty obituary on Alfred Nobel when reviewing a disturbing trend in American entrepreneurship. Admittedly, the connection between the two events is tenuous at best and springs from a fair amount of hope eternal. But stay with us.

Since at least the late 1970’s the number of new businesses as a share of the total has been on a steady decline. During and after the Great Recession, that trend only accelerated. Young firms made up nearly 15% of all companies in 1978. Today they account for less than 8%. Older firms now account for nearly 35% of all companies, the largest share ever. No matter how the official data is sliced, far fewer new businesses are being formed today than at any time for which information is available.

Erudite readers may ask three questions. Does this fact even matter? And, if it does matter, what could be the cause(s)? Can the situation be remedied?

The decline in the formation of new companies is a big deal for a host of reasons. From a macroeconomic point of view, small companies have historically contributed two-thirds of the net new jobs added by the economy, especially in recoveries. Large companies add jobs, but at a lower rate, oftentimes firing as many folks as they hire. New businesses also contribute to the flexibility and dynamism of the economy. They promote innovation, unique thinking, and improved productivity. By definition and like Nobel’s most famous invention, new companies are a positive force of explosive disruption to a marketplace that may otherwise become comfortable and stodgy, maybe even falling into oligopoly.

There are many possible causes of entrepreneurship’s dearth. The laundry list includes a shift away from the entrepreneurial spirit, additional and burdensome regulations at all

levels of government, onerous taxes, insufficient access to capital, demographic problems, and the concentration effect of many large companies in a small area.

We could cite several examples of each potential cause. However, our personal experience tells us that just one of them needs constant vigilance and pruning by the electorate. Government action and the law of unintended consequences have unfortunately grown to become the most egregious root cause which requires remedy. As entrepreneurs ourselves, we have felt the negative impact of new regulations during our relatively short existence.

But we started our commentary with an example of Nobel's premature obituary. Might it be too early to drive the final nail into the coffin of small business? And here is where we hope for hope's sake that, like Alfred Nobel, entrepreneurs have a few more tricks up their sleeves. We find 3 reasons for optimism.

1. "Nascent" businesses, those run by someone who still holds a day job, have doubled since 2010. These "Nascents" are not counted in official records.
2. "Soloists" are not tallied either. There were good reasons for not including them when the past focus had been on employment rather than innovation. However, true soloists might account for 40% of the workforce by 2020. So even small businesses are getting smaller, using technology to inject dynamism into the system.
3. Demographics – The proprietors of Stirling Bridge are members of Gen X, a very tiny generation compared to the Boomers before and the Millennials after. The current slump in new company formation may simply be that our small generation is in the prime age range for business formation. In the coming years as the larger generation of Millennials age, we hope to see them start more than their share of companies.

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Sincerely  
Jason Born, CFA  
President