



The Economic Contribution of Entrepreneurship in Montana

by Nick Holom, Senior Economist

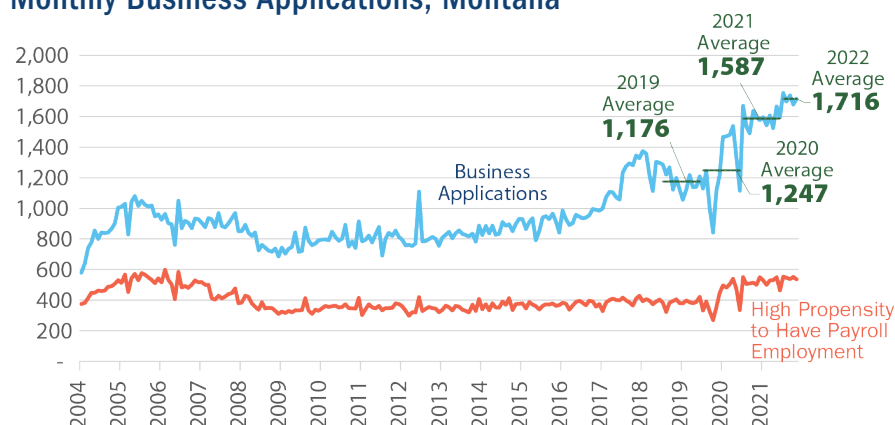
Starting a business can be exciting and daunting. Even with a wealth of experience in the food service industry and a fresh coat of paint to liven up their space, Toodie's cafe owners, Marc and Johanna of Glasgow, Montana, had some unforeseen hiccups in their first days. "We had to scramble at the last minute to replace some staff that didn't work out, and we had some issues with the point-of-sale system, but I'd say it's been a pretty good opening for our first business." Toodie's café has since found a rhythm and is selling breakfast like hotcakes. This article explores the risks and rewards of entrepreneurship in Montana and the economic contribution of new businesses.

Start-Ups Are Really Cookin' in Montana

It may seem strange after the tumultuous few years brought on by the pandemic, but when Montana reopened for business—it really reopened. By all measures, Montana is having rapid growth in new business creation. Business applications in Montana (**Figure 1**) have continued to climb above their previous levels. Average monthly business applications, which were 1,176 in 2019, increased to 1,247 in 2020 despite the pandemic, and have risen even further in 2021 to 1,587. Some applications may never become a business, and some may only be sole proprietors; however, applications for businesses that have a high likelihood of employing more than one person have also increased from an average of 385 per month in 2019 to 520 per month in 2022 (an increase of 135 new businesses applications per month).¹

¹ The identification of high-propensity applications is based on the characteristics of applications including whether it's a corporate entity that has planned wages in one of the following industries: accommodation and food (72), construction, manufacturing, retail, professional and technical services, education, and healthcare. See <https://www.census.gov/econ/bfs/definitions.html> for more details.

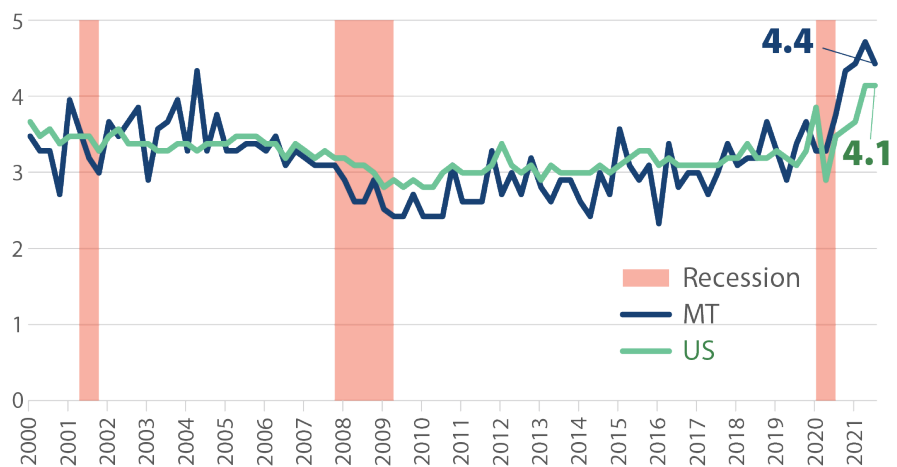
FIGURE 1
Monthly Business Applications, Montana



Source: Business Formation Statistics, U.S. Census Bureau, Montana 2004-May 2022.

A lot can happen between the application process and the formation of a new business establishment. To become a restaurant, Toodie's needed a location, kitchen equipment, a menu, and enough staff to serve their customers. Once Toodie's opens its doors and starts cutting checks, it is officially observed as an establishment in Montana's employment data.² The business establishment birth rate (**Figure 2**) captures new business locations from new firms (like Toodie's) and/or pre-existing firms that open new locations (e.g. Walmart opening a new store location).

FIGURE 2
Business Establishment Birth Rate MT vs US



Source: Bureau of Labor Statistics - Business Employment Dynamics. Data are quarterly.

During a recession, when consumers and businesses have less money to spend, and the risk of failure is higher for new entrepreneurs, the establishment birth rate drops. Following the 2009 recession, Montana's establishment birth rate dropped to 2.3% per quarter, meaning for every 100 establishments only 2.3 new establishments were created. As the economy recovered from 2010 to 2019, the birth rate hovered around 2.8%. Although 2020 saw a brief drop in the establishment birth rate for Montana and the U.S., both have

Montana tends to have a higher share of workers who are their own bosses. Compared to other states, Montana has the second highest rate of proprietary employment (second only to Wyoming), with people who work for themselves making up 27.2% of total employment.

A high rate of proprietary employment can be attributed to rural farm and ranch communities. **Carter**, **Golden Valley**, and **Judith Basin** counties have the highest rates of proprietary employment with over 50% of employment as proprietary. Industrial urban areas tend to have lower rates of proprietary employment (**Cascade** and **Yellowstone** counties have 19% and 21%).

² To be more precise, Toodie's will be recorded as an establishment in the Quarterly Census of Employment and Wages.

recovered and are higher than pre-pandemic levels, with Montana's establishment birth rate (4.4%) outpacing that of the U.S. (4.1%).

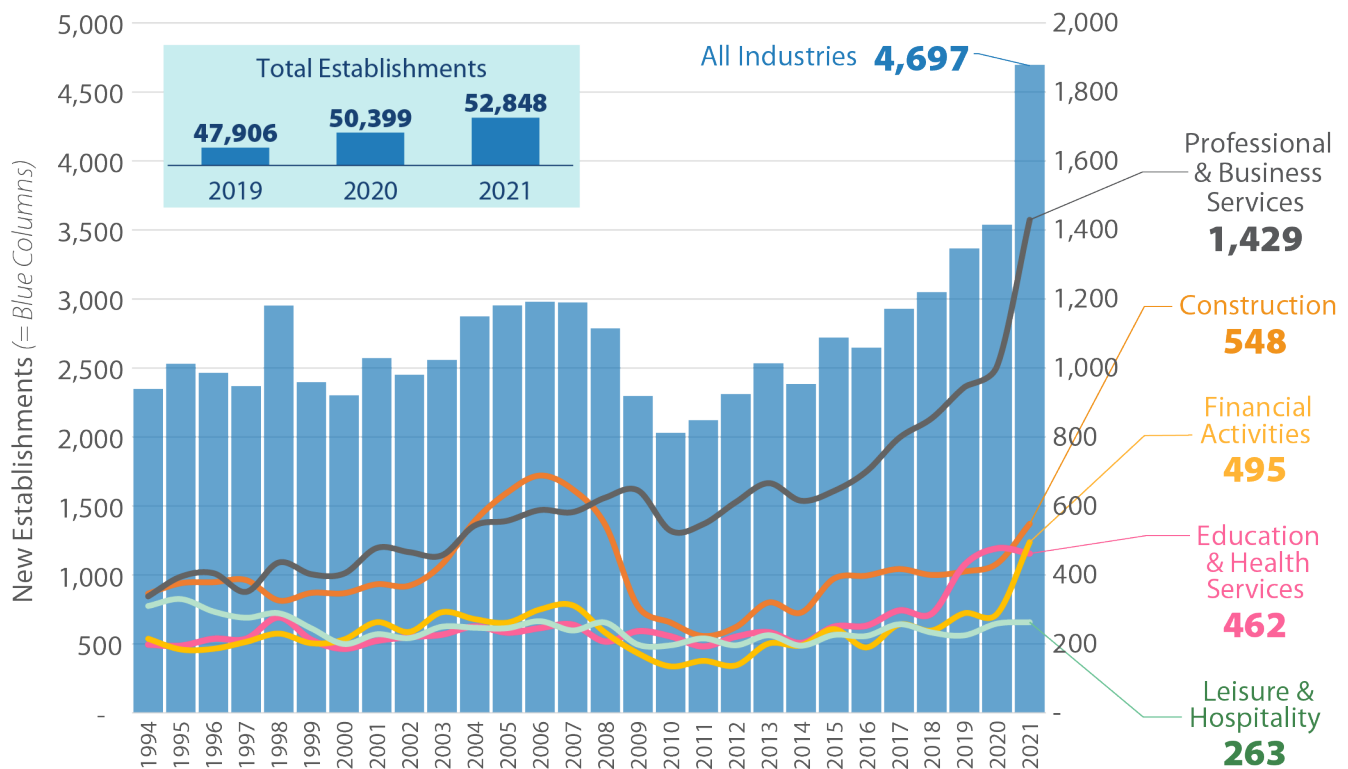
In general, the level of new establishments in Montana has been on an upward trend since 2010, with an even sharper rise over the last year (**Figure 3**). New establishments increased by 1,158 in 2021 compared to 2020. New establishments are being created faster than others are being destroyed, leading to an increase in total establishments of about 2,500 in both 2020 and 2021.

The largest increase in new establishments was in the professional and business services industry, which accounted for 1,429 new establishments, or 30% of all new establishments in 2021. Most growth in professional and business services industry is due

to professional and technical services, which is a subsector that includes computer services, scientific and research services, legal services, architectural services, and accounting services.

Montana's high home prices have resulted in more entrepreneurialism in the construction industry. Montana's median home value went up by approximately \$19,000 in 2020, increasing from \$254K to \$273K.³ Demand for housing has continued to increase while housing supply has lagged, with Montana's population growing faster over the past decade than the number of housing units.⁴ In response to the higher prices, new establishments continue to increase in the construction industry from 433 in 2020 to 548 new establishments in 2021. Increases in total establishments over the period have been highest

FIGURE 3
New Establishments by Industry, Selected Industries, Montana



Source: Bureau of Labor Statistics, Business Employment Dynamics, age and size tables. Total establishments are from the QCEW.

3 Census Bureau ACS 1-Year 2020 estimates via MTDLI's home prices dashboard: <https://lmi.mt.gov/Home/Home-Prices>.

4 According to a report from Pew Charitable Trusts, Montana's population increased by 10% from 2010 to 2020 while its housing units increased by only 7%. https://leg.mt.gov/content/publications/fiscal/2023-Interim/November-2021/Horowitz_Montana_HousingShortage_29Nov2021.pdf

in the specialty trade contractors subsector, which includes contractors performing tasks such as painting, pouring concrete, plumbing, and electrical work.

High demand for real estate and low interest rates over the last two years have likely also contributed to an uptick in new establishments in the financial activities industry. Financial activities had 495 new establishments in 2021 compared to 287 in 2020, with most growth in total establishments coming from real estate and lending activities. Establishment growth in the industry is likely to taper as interest rates rise for consumer and commercial loans.

The leisure and hospitality industry, which includes restaurants, entertainment, and accommodation, has had very little growth in new establishments in recent years, averaging about 250 new establishments per year over the past five years. Demand for new restaurants, hotels, and recreational activity is linked with increased economic activity and population growth. Despite Montana continuing to have net in-migration of about 8,600 people per year between 2015-2019, the level of new leisure and hospitality establishments has remained flat.⁵ As Montana's lowest paying industry, leisure and hospitality may have a harder time capitalizing on increased demand amid the labor shortage, as increased competition over workers may make it more difficult to find the staff to start a business.⁶

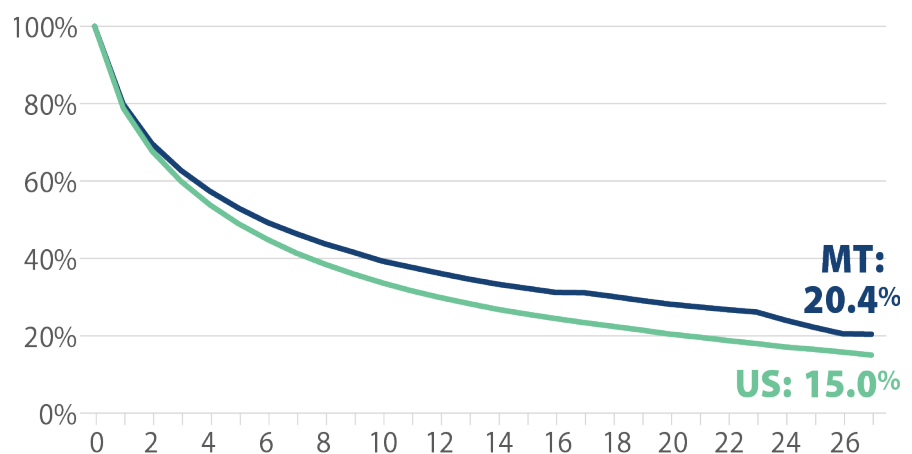
Keeping the Lights On

Conducting market research, writing a business plan, and putting that plan into action by starting a business is one thing; keeping that business alive through competition and economic downturns is another. Business survival depends on many different factors from having a product or service that consumers want to buy to having a little bit of good luck. Even the best business plans may include faulty assumptions about the

costs of operation and the revenue the business will generate. The business survival rates shown in **Figure 4** illustrate how difficult it is for young businesses to survive. About one in five businesses don't survive past their first year and about half don't make it past their fifth year.

Businesses don't always end because they fail. Some businesses close because they are successful. These include businesses that were started with the intention of being purchased by an investor, or family businesses that close when the business owners are ready to retire. Decreases in survival rates among young firms are

FIGURE 4
Business Survival Rates MT vs US



Source: Bureau of Labor Statistics Business Employment Dynamics Data, 1994-2021

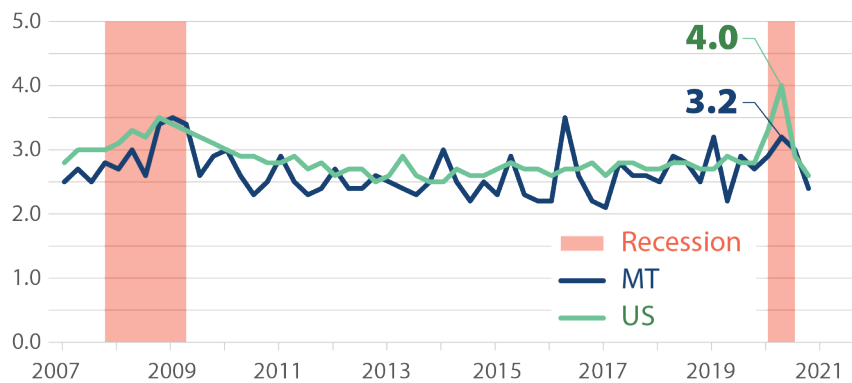
⁵ Census Bureau ACS 5-year estimates, via MTDLI Population Migration dashboard: <https://lmi.mt.gov/Home/population-migration>.

⁶ Leisure and hospitality is made up of the two lowest paying industries, accommodation and food services, and arts, entertainment, and recreation, which had average annual wages of \$22,802 and \$26,960, respectively in 2021 according to data from the Quarterly Census of Employment and Wages feature on MTDLI's Montana Wages dashboard: <https://lmi.mt.gov/montana-wages>.

more likely due to lack of success, which can also be a positive if that knowledge is applied to make the next business endeavor a success.

As business owners gain better knowledge of their customers and develop a good reputation in their communities, the survival curve flattens with fewer businesses selling or going out of business year-to-year. Over the long-run, business survival is higher in Montana than in the U.S., with five percent more businesses in Montana staying in business 27 years after they began.

FIGURE 5
Business Establishment Death Rates MT vs US



Source: Bureau of Labor Statistics Business Employment Dynamics

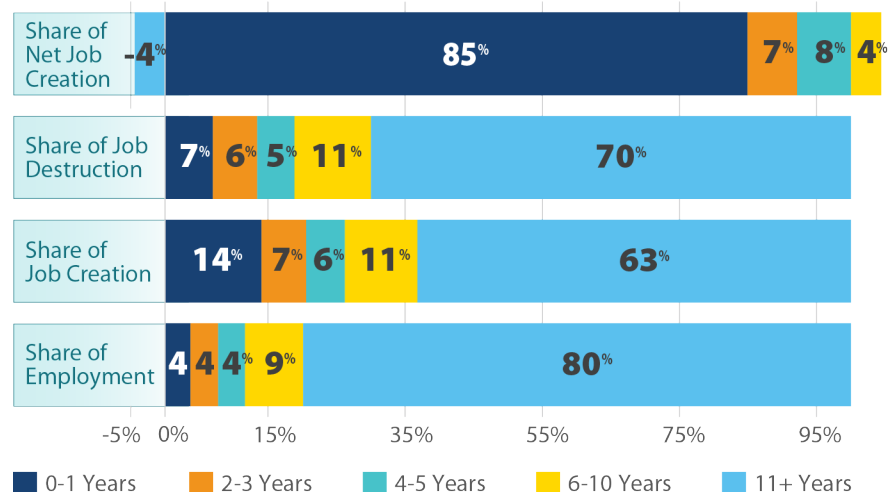
Figure 5 shows that through the pandemic, establishment deaths have been lower in Montana than in the U.S. The establishment death rate shows the percent of establishments that went out of business increased to 4% for the U.S. in 2020Q2, while it increased to only 3.2% for Montana (Montana's average from 2010 to 2019 was 2.6%).⁷ Montana's business death rate has since decreased to 2.4% in the last quarter of 2020, while the death rates for the U.S. decreased to 2.6%.

The Recipe for Job Growth

Total employment has been on a hot streak, reaching 549,000 jobs in May 2022—about 22,000 jobs higher than the month before the pandemic. More Montanans are getting back to work, but underneath that job growth is the churn of new and old businesses and their employment. During the start-up and growth phases, new businesses hire workers and expand until they reach maturity. Though older businesses can innovate and continue to expand, most businesses reach a point where they plateau in size, and either maintain at their current level or start to decline.

Figure 6 shows how Montana's average employment, job creation, and job destruction are distributed across businesses by age group from 2017Q1 to 2021Q2. While businesses in their first year make up 4% of total employment, they contribute 14% of new jobs created and are responsible for 7% of jobs destroyed. Businesses in their first year are responsible for 85% of net job creation.

FIGURE 6
Share of Employment, Job Creation, Destruction, & Net Creation
by Age of Firm, Montana



⁷ A death is defined as an establishment that has at least four quarters of no wages or employment.

Source: Census Bureau Quarterly Workforce Indicators, 2017Q1 to 2021Q2.

As businesses move into growth and expansion phases, they continue to create more jobs than are destroyed. Firms 2-3 years old account for 7% of net job creation, while firms 4-5 years old account for 8%. As firms mature into the 6-10 age group, they make up a larger share of total employment (9%), but a smaller share of net job creation (4%).

Montana's oldest firms account for the largest share of overall employment 80%. As the oldest firms move into periods stagnation and decline, they make up a greater share of job destruction (70%) than job creation (63%). Businesses that are 11+ years old account for -4% to net job creation.

Conclusion

Entrepreneurship is part of what keeps Montana's economy vibrant and growing. New businesses propel Montana's economy forward and provide better, more diverse job opportunities. Starting a new business has its risks. However, without entrepreneurs who are willing to take a chance on a new idea, Montanans wouldn't get to enjoy the wide variety of restaurants and businesses that become community favorites. In the case of Toodie's cafe, which is well on its way to community acclaim, that means a new take on an old idea—breakfast. Order up!

