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THE YOUNG AND THE RESTLESS: THE CONTRIBUTION OF YOUNG FIRMS TO THE ECONOMY

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Summary

Government policy often supports *small* businesses — the so-called 'engine room' of the economy — through lower taxes, lighter labour regulation, and grants. Yet it is actually *young* firms that play the most outsized role in economic dynamism. Using firm-level microdata, we draw out this important distinction between firm size and age in firms' economic contribution, highlighting three key facts.

First, young firms are positive contributors to economic growth while small *old* firms detract from economic growth. For example, young firms contribute 6 percentage points to annual headcount growth, while small old firms *detract* from annual headcount growth by 4½ percentage points.

Second, there is vast heterogeneity among the performance of young firms. By age five, high-performing young firms employ twice the number of workers than the average firm of the same age and are over 40% more productive.

Finally, firm exit is critical to the economy's productivity. Exiting firms are roughly 20% less productive than the industry average even five years before they exit. Their eventual exit reallocates resources towards more productive firms.

Policymakers need to: reconsider size-based business policies; better understand the vast differences in performance amongst young firms; and critically review policy-induced frictions to firm exit.

Australia, like many other advanced economies, is experiencing a persistent decline in economic dynamism. Firm entry and exit rates have declined while market concentration has risen, suggesting weakening competitive pressures and adverse consequences for productivity and economic growth (Hambur and Freestone, 2025). Labour market dynamism has also declined, with job mobility returning to record lows in recent years.

At the centre of these challenges are Australia's businesses. While sometimes overlooked, they are important. Firms bring together labour, capital, and ideas to create goods and services. They also vary widely, not just in what they do, but in their ambition, structure, and productivity. To better understand these dynamics, this note updates and extends prior research by Australian government researchers and the OECD on the role of firm size and age in contributions to economic growth.[1]

New firms contribute a large share of jobs and output growth, while small old firms detract

Conventional aggregate statistics on employment and GDP mask substantial differences in outcomes at the firm level. In any given year, many firms enter or exit, while others scale up or down. To illustrate, we focus on four groups:[2]

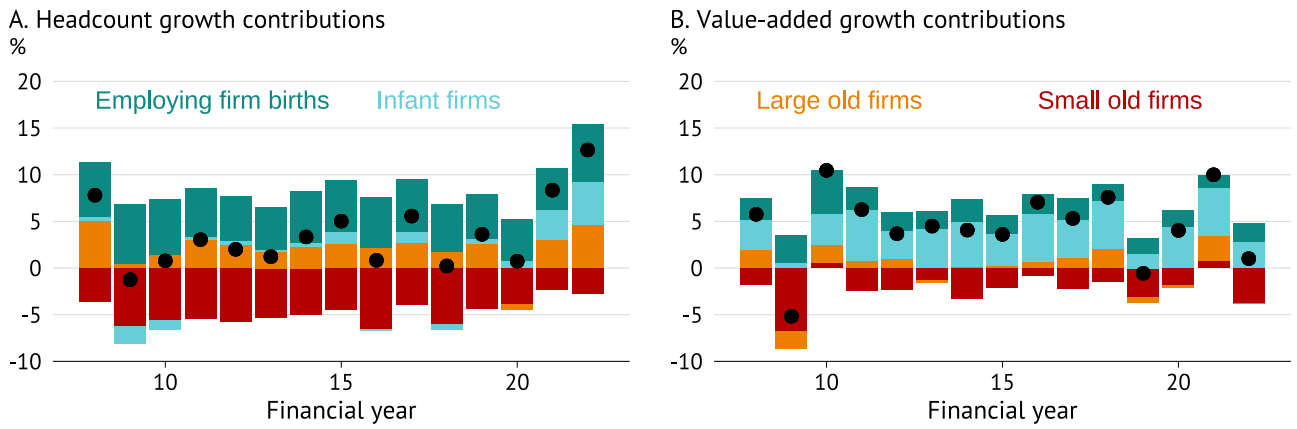
- **Employing firm births**: Firms in their first year of activity, who also employ in that year.
- **Infant firms**: Firms aged five or less, excluding employing firm births.
- **Small old firms**: Firms older than five years that have fewer than 15 employees.[3]
- **Large old firms**: Firms older than five years that have 15 or more employees.

Using this classification and focusing on market-based sectors, we find that firm births and infant firms — rather than small firms — are central to generating jobs and economic activity.[4] This is consistent with findings overseas.[5]

One way to understand firms' economic contribution is by looking at their *net* contribution to annual growth in headcount and value added. Over the past 15 years, young firms (both employing firm births and infant firms) have consistently been the dominant positive contributors (Figure 1).[6] Large old firms also contribute positively in most years, though their impact fluctuates cyclically and can fall to near zero or even negative during downturns. By contrast, small old firms are a consistent net negative, reflecting a mix of stable but stagnant businesses, shrinking firms, and firms exiting the market.

1 See Nguyen and Hansell (2014), Hendrickson et al. (2015), Smith and Hendrickson (2016), Bakhtiari (2017), OECD (2021), and Bakhtiari (2022).
2 See Appendix A.2 for detailed definitions.
3 This follows the *Fair Work Act* definition of small and medium enterprises. There are various approaches to defining firm size.
4 Our analysis excludes the non-market sector and some volatile market industries where productivity measurement is more difficult. See Appendix A.1.
5 See Haltiwanger et al. (2013) on the US and Criscuolo et al. (2014) on the OECD.
6 Further details on the calculations underlying all figures are provided in Appendix A.2.1.

Figure 1: Net contributions to economic growth over time



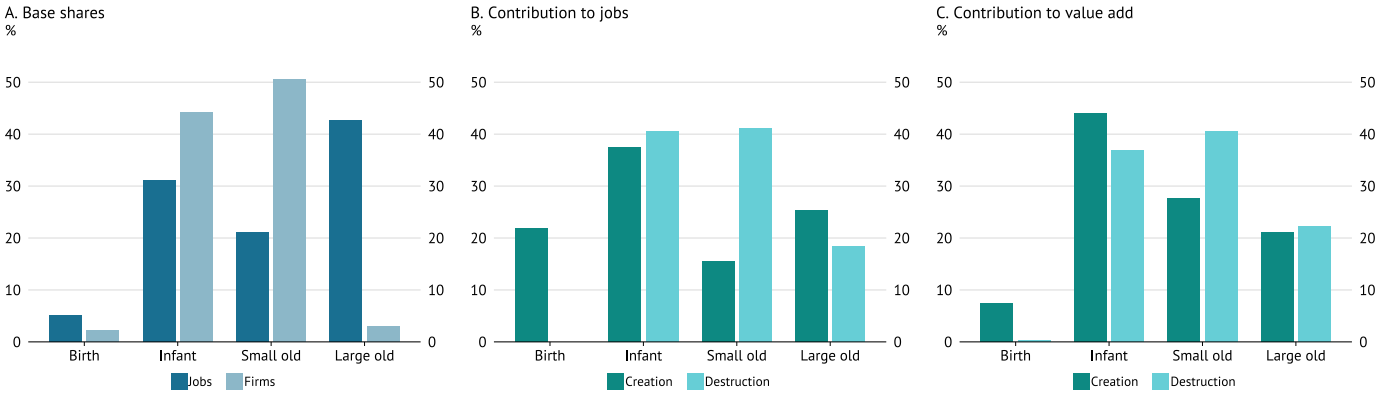
* Dots represent the net contribution to headcount/value-added growth.
Source: ABS BLADE

We also break down firms' contributions to *gross* job and value-added creation – that is, the share of firm-level increases in headcount or value added accounted for by each firm category.[7] We compare these estimates to the number of firms in each category and their share of jobs outstanding, to see which groups are punching above their weight.

We find that employing firm births account for just over 5% of employment, yet generate 22% of job creation (Figure 2).[8] Infant firms' also make a significant (though more proportionate) contribution accounting for nearly 40% of job creation and 45% of value add creation, while making up 31% of jobs and 44% of firms.[9] This highlights that it's not just new firm entry that is important, but also the performance of these firms as they move through their infant years.[10] Large old firms also contribute positively to job creation, though modestly relative to their share of employment.

By contrast, small old firms account for only 15% of job and 28% of value add creation, while accounting for 50% of all firms and over 20% of jobs outstanding. Small old firms are also the largest source of job and value add *destruction* (i.e. the share of firm-level declines in headcount and value-add as firms shrink and/or exit), accounting for 41% and 40% respectively.[11]

Figure 2: Gross contributions to economic growth by firm type



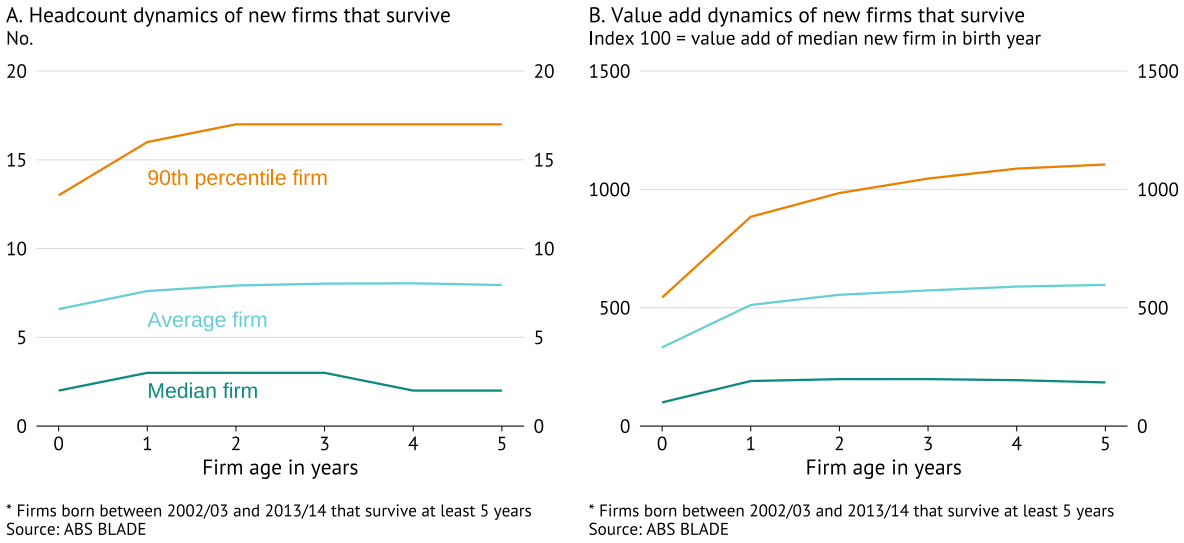
* Analysis based on firm observations from FY08 onwards.
Source: ABS BLADE

7 These are calculated on an annual basis and averaged over the period of analysis, FY08-FY22.
8 These findings are similar to previous US research (Haltiwanger et al., 2013).
9 Although infant firms are strong net contributors to jobs (Figure 1), their share of aggregate job destruction exceeds their share of job creation. This reflects the fact that aggregate job creation is larger than aggregate job destruction overall. Further details on calculation methods are in Appendix A.2.
10 Note, our taxonomy is used for illustrative purposes. One limitation is it provides a static view – what are firm births in one period, are infant firms in future periods. Analysis later in the note provides a more longitudinal view.
11 While the job creation that occurs in firm births must come from somewhere, it is not necessarily mechanical that they come from small old firms. They may come from infant firms or large old firms, which we observe some degree of. They may also come from outside of the employed labour force.

New firms' direct economic contribution plateaus quickly

A closer look at the business lifecycle highlights the importance of a firm's first years of activity. Looking at young firms that survive at least five years - so that the full trajectory of each can be seen - we see the largest increases in headcount and value added during their first two years (Figure 3). This is when firms tend to be most dynamic and when their longer-term trajectory is largely established (Sedláček & Sterk, 2017). Separate analysis updating Bakhtiari (2017), and extending it to value added, reinforces that young firms' positive economic contribution is concentrated (on average) in the first two years of a firm's life (Figure A.3). This suggests that young firms' economic contribution plateaus quickly.

Figure 3: Firm growth by age



* Firms born between 2002/03 and 2013/14 that survive at least 5 years
Source: ABS BLADE

* Firms born between 2002/03 and 2013/14 that survive at least 5 years
Source: ABS BLADE

There is vast heterogeneity among young firms – high-performing firms contribute disproportionately to economic growth and innovation. In our data, firms at the 90th percentile are born with twice the headcount and over 1.5 times the value added of the average firm (and are even bigger relative to the median firm). By age five, 90th percentile firms have double the value added of corresponding firms at birth (a 100% increase), compared with an 80% increase for average firms. By the end of this period, 90th percentile firms record roughly twice the headcount and value added of the average firm.[12]

Exit is also an important part of the firm lifecycle. We estimate that 5% of firms in our sample exit after only one year of operation, while just under 40% of any given cohort of new firms exit by five years of age.[13]

New firms take time to reach their productivity potential, while exiting firms are less productive

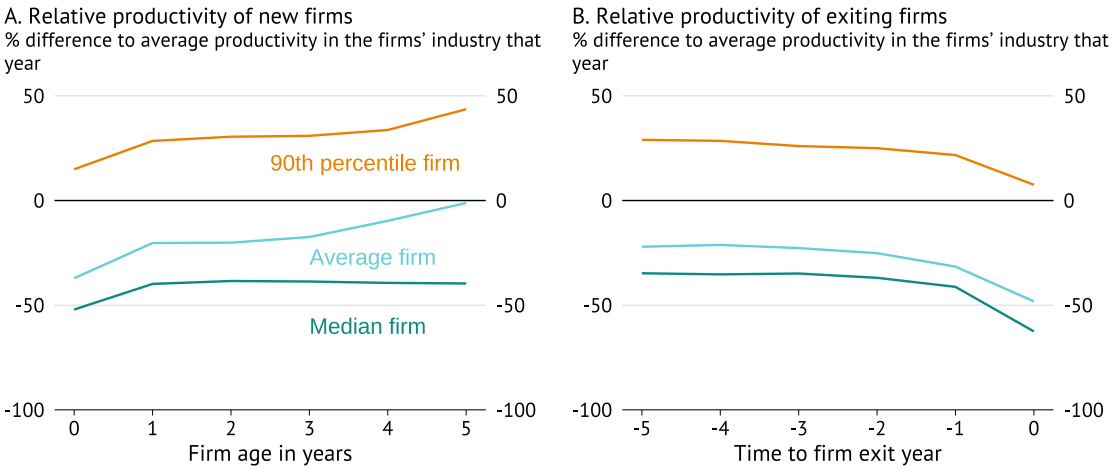
It typically takes time for firms to establish themselves, refine their business model, and achieve operational stability. In the early years of a firm's lifecycle, energy is devoted to making appropriate investments and establishing market share. On average, new firms commence operations at a productivity level of around 40% less than the industry benchmark in that year (Figure 4).[14]

As firms mature, their productivity improves on average. Among those that survive at least five years, productivity of the average firm converges with that of incumbent firms by age five. However, this average masks stark differences, and is pulled up by the highest-performing firms. Firms in the 90th percentile begin with productivity 15% above the industry average, which rises to around 45% above the industry average by age five.

12 Our findings highlights that, in-line with Sterk et al. (2021), there is some degree of ex-ante firm heterogeneity. All firms are not necessarily structured to achieve employment or value-added growth. Some may be started as an alternative to employment, for tax advantages, or for other non-monetary reasons. On the other hand, averages (even at the 90th percentile) mask unique high-growth firms, which international evidence shows contribute disproportionately to economic growth. We hope to explore this heterogeneity in future work.
13 See Figure A.2 for survival curves by birth cohort.
14 The benchmark is the productivity of the average firm in the same industry and year. For age profiles, values relative to the benchmark are averaged across cohorts for given ages. Incumbent firms are included.

This contrasts with the median young firm, which does not achieve the industry productivity benchmark after five years. This highlights that success may not always be immediate (e.g. investment in intangibles may take time to pay off) and that owners start and continue to operate businesses for a range of reasons (e.g. job flexibility) and not solely for financial success.

Figure 4: Relative firm productivity by age



* Firms born between 2002/03 and 2013/14 that survive at least 5 years.
** Industry at the 1-digit ANZSIC division level.
*** Firms must record at least 3 FTE in all years.
Source: ABS BLADE

* Firms exiting between 2007/08 and 2018/19 that existed at least 5 years prior.
** Industry at the 1-digit ANZSIC division level.
*** Firms must record at least 3 FTE in all years.
Source: ABS BLADE

Exit also plays an important role in aggregate productivity. Businesses that exit are (on average) around 20% less productive than the industry average five years prior to exiting.[15] Productivity typically declines further as they approach their exit. This highlights the role of exit in the process of creative destruction: less productive firms leave the market, allowing resources such as labour and capital to be reallocated to more productive and innovative firms. In Australia, there has been a longer-run downward trend in business exit rates indicating that this allocative mechanism may be weakening.

Policymakers should avoid size-based business policies

Our findings show that firms are dynamic and diverse. Some grow and succeed, while others stagnate or exit. This diversity has important implications for economic policy.

Policymakers often focus on protecting or incentivising small businesses to spur growth. However, the rationale for government intervention is often unclear, including what particular market failure policymakers are trying to rectify (e.g. financial frictions, positive spillovers from new ideas and innovations). Explicit business assistance is always fraught with difficulty, but our research shows that size alone is a particularly poor indicator of economic potential. Hence, size-based policies risk supporting businesses that are unlikely to contribute meaningfully to future economic growth, while potentially distorting behaviour (for example, see Andrews et al. (2024)).

The heterogeneity of outcomes among young firms also highlights that more young firms is not necessarily a goal in and of itself. As can be seen in our analysis, some of these new firms grow only a little, eventually becoming the small old firms that detract from growth. Rather, it is a select number of high-performing young firms that drive economic growth through new ideas and innovation – further work is required to better understand these firms.

A healthy economy also relies on the exit of unproductive firms, which frees up resources for more productive businesses (Andrews & Hansell, 2021). However, the rate of firm exit, a core part of 'creative destruction', is falling in Australia, which may slow economic growth. Reducing policy-induced barriers to exit and supporting transitions for affected workers and entrepreneurs will help ensure resources are reallocated to their most productive use.

This note provides an initial overview of firm dynamics. Future work will examine the roles of different types of entrepreneurs and how firm activity varies across sectors, regions, and time.

15 Comparable US research finds that exiting retail establishments are roughly 25% less productive than incumbents (Foster et al., 2006), while prior Australian research finds exiting manufacturing firms are 40% less productive than incumbents (Nguyen & Hansell, 2014).

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A.1. Data description

A.1.1 Data construction

We use data from the Australian Bureau of Statistics' (ABS) Business Longitudinal Analysis Data Environment (BLADE) to conduct our analysis. BLADE is a firm-level data environment that provides a wealth of information on Australian firms. It draws from multiple data sources including the Business Income Tax, Business Activity Statement (BAS) and Pay-As-You-Go data. Surveys conducted by the ABS such as the Business Characteristics Surveys and Business Expenditure on R&D are also available.

The core part of BLADE covers all business with an Australian Business Number for GST purposes at any point in time. The data is available on a financial year basis, starting from financial year 2001/02 and available up to 2022/23. We exclude the first year from our analysis due to potential definitional issues (e.g. many large firms appear to be 'born' in 2001/02 despite likely having been established earlier). We also exclude the most recent year of data (2022/23), which can be subject to later revisions or corrections.

Both incorporated and unincorporated businesses are included, and data are aggregated at the business group level for our analysis. All businesses are included except for those in the following industries:

- Mining;
- Agriculture, Forestry and Fishing;
- Electricity, Gas, Water and Waste Services;
- Finance and Insurance services;
- Public Administration and Safety;
- Education and Training;
- Healthcare and Social Assistance; and
- Arts and Recreation Services.

These industries are often excluded from similar analysis as they tend to face volatile commodity price changes (e.g. agriculture, mining) or are difficult to measure productivity and value added (e.g. non-market industries, finance sector).

The vast majority of businesses in BLADE are small businesses with little to no employees. This can include self-employed businesses or 'mom and pop' shops that are not typically thought of as drivers of growth and innovation. In aggregate, the most common types of businesses are small old firms and infant firms (Figure 2).

Businesses may sometimes appear in the dataset as a result of mergers, acquisitions, the phoenixing of companies, or restructuring of businesses. Since these are not what we consider genuine cases of new firm creation, we attempt to adjust for these events through two main restrictions:

- Exclude any business with more than 500 employees in its first year.
- Remove new businesses with more than 5 employees that recruit over 50% of their workforce from an exiting business in their first year.

Together, these steps help us focus on genuine business births, which are central to our analysis. However, in doing so we may remove some genuine large business births. This, in addition to the industry restrictions, will likely explain any divergence with aggregate statistics as well as other Australian-based analysis. It's possible that larger business births are important for economic growth, and future work will attemp to explore these in more detail.

In some analyses, we restrict the sample to selected birth cohorts to ensure sufficient data (e.g. birth year restrictions to allow sufficient time to analyse growth over a given number of years). These restrictions are noted in the footnotes of each graph.

A.1.2 Definition of key variables

Turnover is the total revenue a business earns from its sales of goods and services over a given period (often called sales or gross income). This variable is taken from the BAS and is deflated using industry-level price deflators.

Value added is the contribution a business makes to the economy. We calculate as output (turnover) minus the cost of goods and services purchased from other firms (intermediate inputs), and reflects the new value created through the business' own labour and capital. This aligns with the concept of GDP, though there are some measurement differences.

Headcount and full-time equivalent (FTE) are standard measures of employment that we use.

Headcount represents the total number of distinct individuals employed by a business in a given financial year, identified through the unique payment summaries issued to each worker. This measure captures the breadth of employment relationships, regardless of whether employees work full-time, part-time, or on a casual basis. With the reported data quality, it is not possible to accurately identify start and end dates within a given year - it should be interpreted as total headcount ever employed in a given financial year.

FTE adjusts for differences in hours worked by converting all employment into full-time equivalent units. This allows for a more accurate assessment of the intensity of labour use and makes it possible to compare employment levels across firms or over time when working arrangements differ. It should be noted that FTE data provided in BLADE are estimates as hours are not observed in the microdata (see Hansell et al. (2015)).

Together, headcount and FTE provide complementary perspectives: headcount reflects the number of people engaged, while FTE reflects the scale of labour engaged. Most of our analysis is based on headcount, as this is a more natural way to consider "jobs". For productivity calculations, we use FTE as it better reflects actual labour input, but we note its limitations.

Labour productivity is defined as as the ratio of value added to FTE employment. We restrict labour productivity analysis to firms recording employment of at least 3 FTE in all years of interest (where used this is noted). This attempts to avoid estimates that are driven or vary significantly due to small changes in employment, and follows approaches used in productivity research elsewhere.

A.2. Methodology

To understand the contributions of different firm types to economic growth we develop a taxonomy of firms that draws inspiration from the firm dynamics literature. These are designed to reflect the different stages of a firm's lifecycle, combined with the prism through which policy often considers firms - their size.

To inform our taxonomy we create new measures of three key definitions to help inform our analysis:

1. **Employing firm birth:** We define a firm birth as the year in which a firm appears in the dataset and employs at least one employee. This is also commonly called a firm entry or startup.[16] Firms who do not employ in their first year are not recorded as a firm birth. We do this to explicitly investigate employing firm births, which appear to be distinct from non-employing firm births, and are likely to yield firm dynamics that are more of interest.
2. **Firm exit:** Firms exit in the last year in which they are observed employing an employee or record positive turnover, whichever occurs later. This can occur prior to the recorded firm exit date in BLADE.
3. **Firm age:** Calculated as the difference between the year of observation and the birth year. For firms who are not recorded as a 'firm birth' above, to define their age we assign a birth year that is the minimum of the year that they record a positive turnover or hire an employee. Our measure of firm age differs from administrative records due to our differing definition of firm birth.

Using these definitions, the firm taxonomy we use is:

- **Employing firm births**: Firms in their first year of activity, who also employ in that year.
- **Infant firms**: Firms aged five or less, excluding employing firm births.
- **Small old firms**: Firms older than five years that have fewer than 15 employees.The latter follows the *Fair Work Act 2009* definition of a small and medium enterprise.
- **Large old firms**: Firms older than five years that have 15 or more employees.

In a firm's exit year we assign them to the category they were observed in the previous year.

A.2.1 Equations for main figures

Net contributions to economic growth over time

The growth figures are generated by:

$$\text{Headcount Growth}_{k,t} = \frac{\text{Headcount}_{k,t} - \text{Headcount}_{k,t-1}}{\text{Headcount}_{t-1}}, \tag{1}$$

$$\text{Value-Added Growth}_{k,t} = \frac{\text{Value added}_{k,t} - \text{Value added}_{k,t-1}}{\text{Value added}_{t-1}}. \tag{2}$$

Where k represents each firm type.

Contributions to economic growth by firm type

This figure displays the share of creation and destruction by firm type. For each variable $X \in \{\text{Headcount}, \text{Value added}\}$, the calculation proceeds in two steps.

16 This can differ from the firm birth date recorded in BLADE, where firms begin before they start employing. Our measure is designed to proxy when the firm begins undertaking economic activity.

Step 1: Aggregate creation and destruction

For each firm type k, we sum absolute changes across all firm–year observations for creation (positive changes) and destruction (negative changes):[17]

$$C_k^{X,+} = \sum_{i \in k} \max\left(\Delta X_i, 0\right), \tag{3}$$

$$C_k^{X,-} = \sum_{i \in k} \max\left(-\Delta X_i, 0\right), \tag{4}$$

where

$$\Delta X_i = X_{i,t} - X_{i,t-1}.$$

Thus, $C_k^{X,+}$ captures total creation and $C_k^{X,-}$ total destruction for firm type k.

Step 2: Proportional contribution

The proportion attributed to each firm type is then:

$$P_k^{X,+} = \frac{C_k^{X,+}}{\sum_k C_k^{X,+}}, \tag{5}$$

$$P_k^{X,-} = \frac{C_k^{X,-}}{\sum_k C_k^{X,-}}. \tag{6}$$

Hence, $P_k^{X,+}$ and $P_k^{X,-}$ represent the shares of total creation and destruction, respectively, accounted for by firm type k. The same procedure applies for both panels of the figure, with X denoting either Headcount or Value added.

Firm growth by age

Percentiles are calculated based on firm age, using either headcount or value added as the variable of interest. For each firm age, we pool observations across all time periods and compute summary statistics. In this setup, firms are implicitly allowed to move across percentile groups as they age, since the calculation is based on the distribution at each firm age. For value add, the y-axis denotes value add of an individual firm indexed to the value add of the median new firm in its birth year.

Relative firm productivity by age

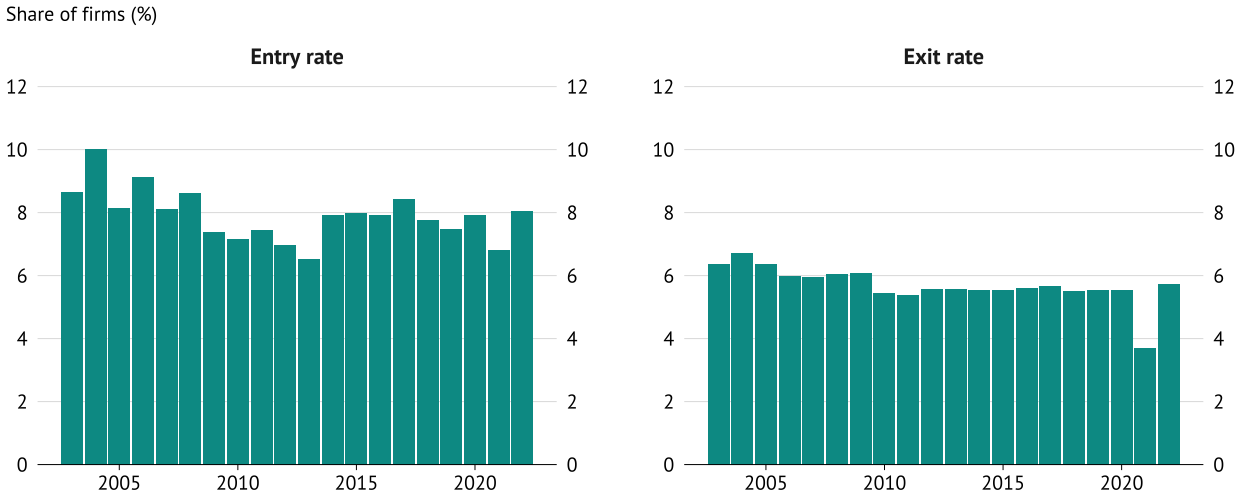
This figure reports the distribution of relative productivity across firms, measured as the percentage difference between a firm's productivity and the average productivity in its industry–year. Percentiles (e.g. median, 90th) are then calculated grouped by either firm age (Panel A) or time to exit (Panel B). As in Figure 3, firms are not locked into a fixed group: they may move between percentile ranks as they evolve over their lifecycle.

17 Note, the max function implicitly separates firms into creation or destruction.

A.3. Descriptive statistics

We define the firm entry (exit) rate as the number of employing firms that enter (exit) in that year as a proportion of employing firms in the previous year. In our restricted and modified BLADE dataset the firm entry rate has been trending gradually downwards over time, similar to the aggregate economy (Figure A.1).[18] Across the same period, exit rates have also slightly declined.[19]

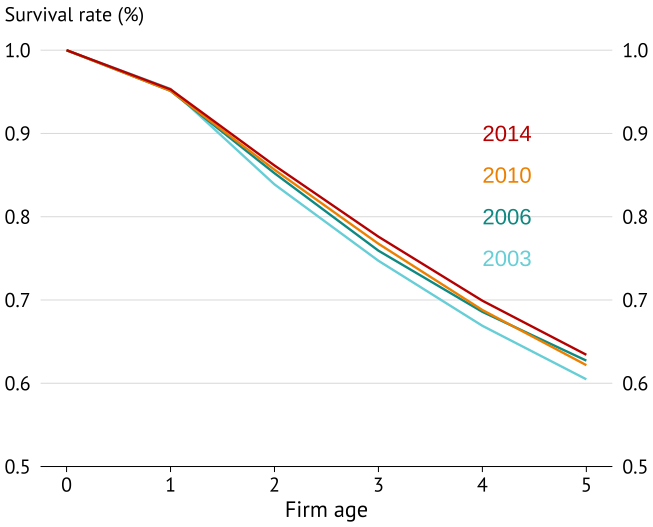
Figure A.1: Entry and exit rates of businesses



Source: ABS BLADE

We use a simple definition of the firm survival rate: the share of firms from a given birth cohort that remain active - that is, firms operating in any year between and including their birth and exit years, as a proportion of firms that were born in that initial year.[20] We find that business survival rates have been trending upwards in recent years (Figure A.2). Our analysis focuses on firms born in 2017 or earlier, to allow adequate time to track survival over time, and compare different cohorts.

Figure A.2: Survival curves



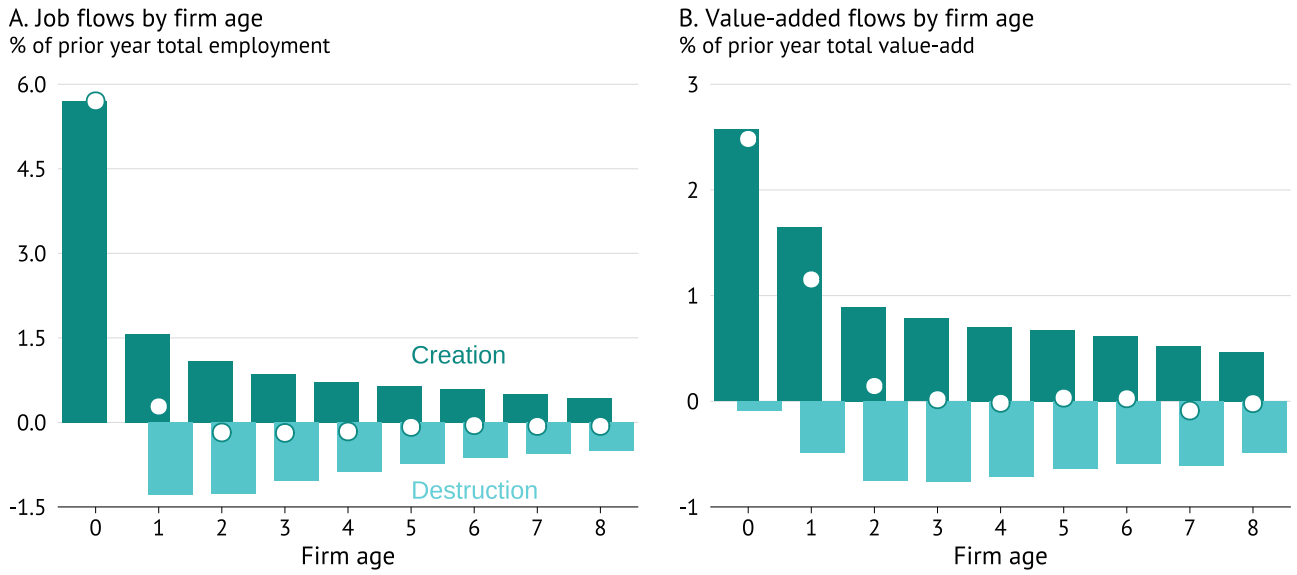
Source: ABS BLADE

18 In aggregate data, the decline in entry and exit rates is slightly more pronounced.
19 Due to data irregularities in FY2005, the exit rate has been interpolated for that year.
20 Due to ABS DataLab output clearance rules, we have applied perturbation to our results.

While this may seem like a positive sign for the economy, it could indicate that some firms are surviving longer, tying up resources, and preventing new firms entering. If the firms surviving are of lower quality, then this may result in resources such as labour and capital being tied up in less productive firms rather than potentially more productive and innovative firms.

Following the analysis of Bakhtiari (2017), updating and extending it, we find that (in aggregate) net job creation is driven by firms' first two years (Figure A.3A). We also find a similar pattern for value add (Figure A.3B), where firms up to age two contribute positively. After age 2, firms (in aggregate) no longer make net positive contributions to employment or value add. These results highlight the importance of a firms' first years to their growth. However, it's important to note that these aggregate numbers hide significant variation in firm performance within firm age groups, which we explore earlier in this note and in future work.[21]

Figure A.3: Job and value add flows by firm age



* The dark blue bars are creation figures; the light blue bars are destruction figures; the dot represents net figures.
Source: ABS BLADE

21 While our estimates are similar to Bakhtiari (2017), they may differ from other estimates due to restrictions we have placed on the dataset. See Appendix A.1 for further details on data restrictions.

A.4. ABS BLADE data disclaimer

This paper uses unit record data held in the BLADE data environment which is hosted by the Australian Bureau of Statistics. The results are based, in part, on Australian Business Register (ABR) data supplied by the Registrar to the Australian Bureau of Statistics (ABS) under A New Tax System (Australian Business Number) Act 1999 and tax data supplied by the Australian Taxation Office (ATO) to the ABS under the Taxation Administration Act 1953. These require that such data are only used for the purpose of carrying out functions of the ABS. No individual information collected under the Census and Statistics Act 1905 is provided back to the Registrar or ATO for administrative or regulatory purposes. Any discussion of data limitations or weaknesses is in the context of using the data for statistical purposes, and is not related to the ability of the data to support the ABR or ATO's core operational requirements. Legislative requirements to ensure privacy and secrecy of this data have been followed. Only people authorised under the Australian Bureau of Statistics Act 1975 have been allowed to view data about any particular firm in conducting these analyses. In accordance with the Census and Statistics Act 1905, results have been confidentialised to ensure that they are not likely to enable identification of a particular person or organisation.

Legislative requirements to ensure privacy and secrecy of these data have been followed. For access to MADIP and/or BLADE data under Section 16A of the ABS Act 1975 or enabled by section 15 of the Census and Statistics (Information Release and Access) Determination 2018, source data are de-identified and so data about specific individuals has not been viewed in conducting this analysis. In accordance with the Census and Statistics Act 1905, results have been treated where necessary to ensure that they are not likely to enable identification of a particular person or organisation.