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An exodus in the labor force—but to where?

Nicholas A. Schaffer

Many economists have long considered recessions a period of economic reorganization in which firms that have allocated their resources poorly are unseated by new, more productive firms. Does this belief still hold up today? In their paper "Flight to safety: how economic downturns affect talent flows to startups" (National Bureau of Economic Research, Working Paper 27907, October 2020), Shai Bernstein, Richard R. Townsend, and Ting Xu suggest that the tradition of new firms pushing out the old may no longer be true. One may think that during recessions, those who lose their jobs at established firms may realize a lower opportunity cost in joining a smaller startup. Alternatively, one might expect to observe a "flight to safety" as workers seek the believed relative security of a more established firm.

Using data from the recruiting site AngelList, the authors were able to evaluate the size and age of a firm as well as the experience and quality of a job candidate. To evaluate the talent flow to a startup, Bernstein and colleagues measured the number of job applications per job posting. They were also able to note how firms responded to job applications. Job candidate quality was assessed by the researchers on two metrics. The first was a candidate's years of experience. The second metric, generated by AngelList, was a quality score that evaluated candidates based on their education, skills, experience, and actions taken on AngelList.

The authors found that during the economic downturn that resulted from the coronavirus disease 2019 (COVID-19), job seekers turned their attention away from smaller startups and toward larger, more established firms. This finding was especially true among higher skilled job seekers. After the beginning of the COVID-19 crisis, the quality and quantity of talent available to fledgling startups decreased markedly. But how were startups affected by this change? After the onset of the pandemic, firms overall received less applications to postings. This trend, however, was much stronger for smaller and younger firms. Although the researchers found that higher quality job candidates were more likely to pivot toward larger and older firms, they also note that the move by jobseekers away from startups has not been a general downward trend but instead a new development since the outbreak of COVID-19.

The authors discovered that a substantial "brain drain," an emigration of the most qualified candidates, afflicted startups since the onset of the pandemic. How did smaller firms and younger firms respond? Do they hire the best candidate available to them? Or simply dial back on hiring altogether? The authors learned that startup firms were less likely to respond positively to a job application than before the pandemic because of the diminished talent pool. Conversely, established firms experienced a negligible change in their responses to job applications. This stark difference in application responses reveals the difficulty of a poorer talent pool for startups. When confronted with a diminished talent pool, startups chose to suspend recruitment as opposed to hiring an undesirable candidate.