

ENTREPRENEURSHIP POLICY DIGEST

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RETHINKING NON-COMPETES: UNLOCK TALENT TO SEED GROWTH

The ability of an entrepreneur to start a new business matters for economic growth because new companies account for nearly all [net new job creation](#). To fill these new jobs and fuel firm expansion, young companies need access to talented workers. Yet, if potential entrepreneurs and skilled employees are locked out of new opportunities, job creation and economic growth will be hindered.

The free movement of individuals in and out of jobs is a crucial component of an entrepreneur-driven economy, in which those with good ideas can easily leave employment to start new businesses. Strict state enforcement of contracts that forbid exiting employees from working for competitors or launching their own company, however, can disrupt entrepreneurship by erecting a barrier to mobility.

The pervasiveness of non-compete agreements among all employees, but especially among highly skilled workers, has been steadily increasing. Nine out of ten [managers and technical employees now report being subject to these constraints](#).

While [the number of workers subject to non-compete agreements is increasing](#), the degree to which a former employee will be restricted from related employment or entrepreneurship differs depending on the state in which he resides. Most states allow non-compete agreements under some degree of reasonable protection of a legitimate business interest, and the terms can be upheld or overruled by a judge. Famously, California courts rarely enforce non-compete clauses, while some states, like Florida, are more stringent in their enforcement.

IMPACTS ON INDIVIDUALS AND FIRMS

- In states that strictly enforce non-compete agreements, individuals bound by these restrictions [report lower compensation](#) in their next job, skill atrophy, and a degradation of professional networks as a result of not being able to work in their chosen industry.
- Even just the existence of non-compete agreements can [dampen entrepreneurship](#). Research suggests that the [presence of looming lawsuits](#) from larger and older companies with the financial resources to engage in legal battles prevents the creation of new firms.
- Firms that use non-compete agreements in states that enforce them receive [lower rates of return](#) on venture capital investment than those that don't.
- In states that strictly enforce non-compete agreements, firms are shown to be more willing to [pursue riskier R&D strategies](#) and [invest in more worker training](#) for their employees.
- An absence of non-compete agreements doesn't mean that former employees are free to steal ideas and processes from previous employers. Non-disclosure and confidentiality agreements, along with the [Unified Trade Secrets Act](#), provide similar protections as non-competes without stifling entrepreneurial innovation and economic growth.

(Continued)



THE ECONOMIC EFFECTS

- If non-compete agreements are strictly enforced in one state, evidence suggests that workers are [less likely to change jobs](#). In addition, [high-quality workers with talent and creativity may emigrate](#) to states that will not enforce existing non-compete agreements. (see “Non-Competes and Migration: The Michigan Case”)
- Non-compete agreements also may exacerbate [inequality](#). Wealthier individuals may be less severely economically impacted while they wait for their non-compete agreement to expire. However, those who cannot afford to sit on the sidelines are left with few options except those that provide opportunities not in their field or those with compensation below the skill level of the employee.

EXAMINE YOUR STATE

Laws governing non-compete agreements can be adjusted to improve labor mobility and liberate entrepreneurs.

DISCLOSE EARLIER

- The requirement to sign a non-compete agreement often is not disclosed until after a new [employee has already accepted](#) a job offer. Mandate early disclosure to job seekers of requirements to sign non-competes.

SHORTEN THE DURATION

- Limit the duration of non-compete agreements to no more than one year to mitigate their tempering effects on entrepreneurship.

NARROW THE SCOPE

- Non-compete agreements traditionally have existed in technology industries or to protect corporate secrets. Their spread to [summer camp counselors and hair stylists](#), however, seems more about artificially restricting competition than protecting employer investment. Narrow the scope for which non-competes may be enforced so that it truly is a company’s human capital investment that is protected.

LEVEL THE FIELD

- Facilitate more equitable workplace agreements by requiring employers to provide additional compensation to existing employees who are asked to submit to non-compete restrictions.

NON-COMPETES AND MIGRATION: THE MICHIGAN CASE

In 1985, the State of Michigan enacted the [Michigan Antitrust Reform Act](#), which among other things, unintentionally ended the ban on non-compete agreements. MIT researcher Matt Marx studied how this unexpected change [affected migration patterns out of Michigan](#) from the most productive and collaborative workers. He concluded that emigration from Michigan to states that did not enforce non-compete agreements increased until the law was changed. Specifically, individuals who left the state were the most creative and talented, including many potential entrepreneurs. This “brain drain,” as Marx calls it, resulted in highly skilled technical professionals leaving Michigan, which lowered the ceiling for potential economic growth.

FOR MORE INFORMATION

Click on the links for access to the following resources, or contact Jason Wiens at jwiens@kauffman.org:

- Read the Kauffman Foundation’s [Startup Act for the States](#)
- Read [Matt Marx’s research on non-compete agreements](#)
- Consult [Non-Compete Clauses: An International Guide](#)
- Read [Non-Compete Agreements: Barriers to Entry...and Exit?](#)



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