HOUSE COMMITTEE ON ECONOMIC DEVELOPMENT AND BUSINESS

Friday, March 14, 2014

9:00 a.m.

State Capitol, Conference Room 312

Greetings Chair Tsuji, Vice Chair Ward, and Members of the Committee on Economic Development and Business:

My name is Matt Marx. I am the Assistant Professor of Technological Innovation, Entrepreneurship, and Strategic Management at the MIT Sloan School of Management. My research, supported by others in my field, concludes regional “brain drains” are directly related by public policy affecting employee mobility. I strongly support SB 3126, SD 2 as a means for Hawaii to retain its top talent.

2014 marks an inauspicious anniversary: 600 years since the first employee non-compete lawsuit was filed. It was in northern England, in the very high-tech industry of clothes-dyeing. An apprentice was sued by his master for setting up his own clothes-dyeing shop in the same town in 1414. The judge, appalled that the master would try to prevent his own apprentice from practicing his profession, threw out the case and threatened the plaintiff with jail time.

Much has changed in 600 years, but employee non-compete agreements still bear painful resemblance to medieval practices. As a professor at the MIT Sloan School of Management, my research focuses on the implications of non-competes for individuals, firms, and regions. I am not alone in this effort; during the last ten years, several scholars have contributed to a body of work including

* Toby Stuart of the University of California at Berkeley
* Olav Sorenson of Yale University
* Mark Garmaise of UCLA
* Mark Schankerman of the London School of Economics
* Lee Fleming of the University of California at Berkeley
* Jim Rebitzer of Boston University
* April Franco of the University of Toronto
* Ronald Gilson of Stanford University
* Ken Younge of Purdue University
* Sampsa Samila of the National University of Singapore
* Ivan Png of the National University of Singapore

My work, as well as that of those of these scholars, has almost universally found non-competes to be detrimental to individual careers and regional productivity. Non-competes, do not, as is often claimed, spur R&D investment by companies. Just to summarize a few points:

* Although it is frequently claimed that non-competes are usually only a year in duration, a survey I conducted of more than 1,000 members of the IEEE engineering organization revealed that fully one-third of these are longer than one year and 15% are longer than two years.
* An article of mine in the American Sociological Review reveals that firms rarely tell would-be employees about the non-compete in their offer letter. Nearly 70% of the time, they wait until after the candidate has accepted the job and, consequently, has turned down other job offers. Half the time the non-compete is given on or after the first day at work. At this point it is too late for the employee to negotiate—indeed, I found that barely one in ten survey respondents had a lawyer review the non-compete.
* Several articles including my own with Lee Fleming and Debbie Strumsky in Management Science, by Jim Rebitzer and two Federal Reserve economists in the Review of Economics and Statistics, by Mark Garmaise in the Journal of Law, Economics, and Organization find that non-competes make it difficult for employees to change jobs. Instead, workers are trapped in their jobs with little possibility of moving elsewhere.

In the remainder of my testimony I wish to comment on the “chilling effect” non-competes can have regardless of the best intentions of judges and the possible implications for regional economic performance.

Jay Shepherd of the Shepherd Law Group reports that there were 1,017 published non-compete decisions in 2010. The Bureau of Labor Statistics reported that there were 154,767,000 workers in the U.S. as of June 2010. If the effect of non-competes were limited to the courtroom, simple math would suggest that 0.0007% of workers were affected by non-competes. Yet data from my IEEE survey indicate that nearly half of engineers and scientists are required to sign non-competes (including states where they are unenforceable). Why are 50% of workers asked to sign non-competes when barely a thousandth of a percent of them ever involve a court case? It is because of *the chilling effect*—because non-competes affect worker behavior even in the absence of a lawsuit. Thus it is essential to account for and anticipate how non-competes affect workers outside the courtroom.

In my own research including interviews with dozens of workers, I have rarely if ever come across an actual lawsuit. However, I have seen several instances where workers have taken a *career detour*, leaving their industry for a year or longer due to the non-compete. They took a pay cut and lost touch with their professional colleagues—not because they were sued, but for other reasons. They may have been verbally threatened by their employer; they may not have been threatened but have assumed that if they were sued, they would lose due to the expense of defending themselves; in some cases they felt that they were under obligation to honor the agreement they had signed—no matter how overreaching it might have been.

Non-compete reform is not just about protecting workers; it is also about growing the economy. Some will say it is impossible to operate their business without non-competes. Perhaps it is easier not to worry about people leaving, but one need look no further than California’s Silicon Valley or the San Diego biotech cluster for proof that a thriving economy does not depend on non-competes. Non-competes have been banned in California for more than 100 years. Again, I acknowledge that as a manager life is easier when you can rely on employees not leaving for rivals thanks to the non-compete they were required to sign. When I was managing a team of engineers in Boston, I never really worried about people quitting. Whereas when I managed a team in Silicon Valley, I realized that we as a company had to keep them engaged. We had a saying: “you never stop hiring someone.” I think it made us a better company, and it made me a better manager.

Non-competes hurt the economy because it is more difficult to start new companies and also to grow those companies. Professors Olav Sorenson of Yale University and Toby Stuart of the University of California at Berkeley published a study in 2003 showing that the spawning of new startups following liquidity events (i.e., IPOs or acquisitions) is attenuated where non-competes are enforceable. Professor Sorenson followed up this study with a more recent article, coauthored with Professor Sampsa Samila at the National University of Singapore. They show that a dollar of venture capital goes further in creating startups, patents, and jobs where non-competes are not enforceable. Their finding is moreover is not just a Silicon Valley story but holds when Silicon Valley is excluded entirely.

Non-competes not only make it more difficult to start a company; they make it harder to grow a startup. One of the randomly-selected interviewees in my American Sociological Review article said that he “consciously excluded small companies because I felt I couldn’t burden them with the risk of being sued. [They] wouldn’t necessarily be able to survive the lawsuit whereas a larger company would.” Also, whereas large companies are able to provide a holding-tank of sorts for new hires to work in a different area while waiting for the non-compete to expire, this is more difficult for smaller firms.

Finally, and perhaps of even greater concern, is that non-competes chase some of the best talent out of a region. I have included my research on a 1985 change in public policy in Michigan to start enforcing noncompetition agreements. My research indicated that the change accelerated the emigration of inventors from the state and moreover to other states that continued not to enforce non-compete agreements. This finding is not simply an artifact of the automotive industry or general westward migration; in fact, it is robust to a variety of tests including pretending that the policy change happened in Ohio or other nearby, mid-sized Midwestern states. Worse, this “brain drain” due to non-compete agreements is greater for the most highly skilled workers. It stands to reason that a change in public policy like SB 3126, SD 2 would promote the retention of top talent in Hawaii.

References

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