“The Cyclical Composition of Startups”

This paper proposes a new theory of business cycles based on the idea that financial uncertainty shocks change the nature of innovation. When investors become more risk tolerant, they fund riskier startups with greater growth potential. As these ambitious startups grow, the initial shock propagates and generates a boom in output and employment. I develop a heterogeneous firm industry model of the US business sector with countercyclical risk premia and innovation by startups and existing firms. The quantitative implementation of the model jointly matches time series properties of stock returns and macroeconomic aggregates, as well as micro evidence on firm cohort growth over the cycle.