

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0515

Memorandum

To: Members, Committee on Small Business
From: Committee Staff
Date: February 12, 2018
Re: Hearing: “Job Creation, Competition, and Small Business’ Role in the United States Economy”

I. Introduction

On Wednesday, February 14 at 11:00 A.M., the House Committee on Small Business will hold a hearing titled, “Job Creation, Competition, and Small Business’ Role in the United States Economy.” The hearing will provide Committee Members with the opportunity to discuss new research conducted by Goldman Sachs regarding the effect of access to capital on small firms’ growth and expansion. The hearing will also explore economic trends that show small firms’ access to capital, particularly in large urban and remote rural areas, has been slower to recover. Finally, the hearing will feature small business owners who have graduated from Goldman Sachs *10,000 Small Businesses* program, offering insight as to what private sector resources can be available to small firms seeking assistance to grow.

II. Small Business Landscape

Since the end of the Great Recession in the summer of 2009,¹ the United States economy has slowly been improving.² Recent trends, such as growth in small business optimism scores³ and a decreasing unemployment rate,⁴ indicate overall economic confidence. Despite promising macroeconomic conditions, the lending and financial environment continue to remain stagnant for businesses.⁵ For small businesses, which regularly utilize commercial bank borrowing for expansion projects and other endeavors, a tepid lending environment is troubling. With capital options limited, small businesses often turn to the Small Business Administration (SBA) to finance their undertakings. As a way to bridge the lending gaps that exist in the marketplace for the nation’s smallest firms, the SBA administers several capital access programs, including its flagship program, the 7(a) Loan Program.

¹ ROBERT RICH, FEDERAL RESERVE BANK OF NEW YORK, THE GREAT RECESSION, FEDERAL RESERVE HISTORY (2013), available at https://www.federalreservehistory.org/essays/great_recession_of_200709.

² <https://fred.stlouisfed.org/series/A191RL1Q225SBEA>.

³ NATIONAL FEDERATION OF INDEPENDENT BUSINESS: DECEMBER 2017 REPORT: SMALL BUSINESS OPTIMISM INDEX (2017), available at <https://www.nfib.com/surveys/small-business-economic-trends/>.

⁴ <https://data.bls.gov/timeseries/LNS14000000>.

⁵ <https://fred.stlouisfed.org/series/CILACBQ158SBOG>.

With roughly 30 million small businesses that employ 47.8 percent of private sector employees and make up 99.9 percent of all firms, small businesses make up a significant part of the United States economy.⁶ Small businesses also create roughly two of every three net new jobs in the United States, making them the primary engine of job creation and economic growth.⁷ Although small businesses are clearly an important factor in job creation and economic growth, access to capital has become an increasingly pressing issue for millions of small businesses. According to a 2017 survey by the United States Chamber of Commerce, although 40 percent of small business executives would like to increase capital investments, 53 percent of small business executives report that access to affordable credit has not improved in the past year.⁸ These sentiments were also echoed in the Federal Reserve 2016 Small Business Credit Survey, which found that two thirds of small firms obtain less than the amount sought when applying for a loan, compared to only 45 percent of large firms.⁹ While many large businesses are able to better utilize other options such as debt and equity markets, small businesses are left with more limited options.

In terms of where small businesses receive financing, banking consolidation and regulation have forced small businesses to turn toward other methods of financing in order to satisfy their credit needs. Although community banks hold only 13 percent of total industry assets, they make up more than 50 percent of all small business loans.¹⁰ This is in large part due to the fact that community bank lending to small businesses heavily relies on relationship-based lending.¹¹ While small businesses have a variety of options to acquire capital, loans from small banks received the highest satisfaction rate from small business owners.¹²

Although there is a proven track record between community banks and small businesses, the number of community banks in the United States has declined significantly in recent years. The amount of banks in the United States decreased from 17,901 in 1984 to only 7,357 in 2011.¹³ During this same time period, the number of banks with less than \$25 million in assets declined by 96 percent.¹⁴ With this precipitous decline in community banks, many small businesses have had to resort to other financing methods to operate and expand their businesses.

⁶ OFFICE OF THE CHIEF COUNSEL FOR ADVOCACY, SMALL BUSINESS ADMINISTRATION, FREQUENTLY ASKED QUESTIONS 1 (2016) [hereinafter Advocacy FAQ], available at https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf.

⁷ *Id.*

⁸ U.S. CHAMBER OF COMMERCE FOUNDATION, CENTER FOR CAPITAL MARKERS AND COMPETITIVENESS, KEY POINTS FROM FINANCIAL SERVICES SURVEY (2017), available at <http://www.centerforcapitalmarkets.com/wp-content/uploads/2013/08/Financial-Services-Survey-For-Small-Businesses-Growth-and-Credit-Go-Hand-in-Hand.pdf?x48633>.

⁹ FEDERAL RESERVE BANK, 2016 SMALL BUSINESS CREDIT SURVEY: REPORT ON EMPLOYER FIRMS IV (2017) [hereinafter Fed Survey], available at <https://www.newyorkfed.org/medialibrary/media/smallbusiness/2016/SBCS-Report-EmployerFirms-2016.pdf>.

¹⁰ FEDERAL DEPOSIT INSURANCE CORPORATION, FDIC COMMUNITY BANKING STUDY 1 (2012) [hereinafter FDIC Community Banks], available at <https://www.fdic.gov/regulations/resources/cbi/report/cbsi-execsumm.pdf>.

¹¹ Federal Reserve Governor Lael Brainard, Address at the Third Annual Community Banking and Policy Conference (September 30, 2015), available at <https://www.federalreserve.gov/newsevents/speech/brainard20150930a.htm>.

¹² Fed Survey, *supra* note 9 at 17.

¹³ FDIC Community Banks, *supra* note 10 at 1.

¹⁴ *Id.*

III. Recent Entrepreneurship Trends

In 2015, 679,072 new businesses were established in the United States.¹⁵ These businesses created 3 million jobs.¹⁶ Because the average new business created in 2015 had roughly 4.5 employees, almost all new businesses fit the criteria to be considered a small business.¹⁷

Entrepreneurship and the formation of new businesses has declined by almost 50 percent since 1978.¹⁸ The rate of the decline accelerated during and immediately after the Great Recession, and in 2010, there were more business deaths than births.¹⁹ The businesses created just after the Great Recession were also concentrated in a select few metropolitan areas. From 2010-2014, there were only 166,460 net new startups created; half of which were located in 20 counties.²⁰ On the contrary, from 1992 to 1996, there were approximately 420,850 net new startups created; half of which were located across 125 counties in the United States. Additionally, the population in 1992 was only 83 percent of the United States population in 2010, meaning the business formation rate per capita has fallen considerably.²¹

Recent trends indicate that entrepreneurship and business formation are slowly improving. According to the 2016 Kauffman Index of Entrepreneurship Series, startup activity, local small business activity, and the growth of entrepreneurship have all recovered since the Great Recession.²² Also, the survival rate of new businesses after their first five years in operation fully recovered by 2014.²³ While these are positive indicators toward improved entrepreneurship, these recent statistics still exist within the previously mentioned long-term decline in entrepreneurship.²⁴ Therefore, it is important to further understand how depressed entrepreneurship can affect broader issues in the United States economy.

¹⁵ BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, ENTREPRENEURSHIP AND THE UNITED STATES ECONOMY, NUMBER OF ESTABLISHMENTS LESS THAN 1 YEAR OLD, MARCH 1994–MARCH 2015 (2016) [hereinafter Startup Statistics], available at https://www.bls.gov/bdm/entrepreneurship/bdm_chart1.htm.

¹⁶ UNITED STATES DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, ENTREPRENEURSHIP AND THE UNITED STATES ECONOMY, BUSINESS ESTABLISHMENT AGE (2016), available at <https://www.bls.gov/bdm/entrepreneurship/entrepreneurship.htm>.

¹⁷ *Id.* There are numerous ways the federal government defines “small business.” For the purposes of this memorandum, we will use the Small Business Office of Advocacy definition of a small business as an independent business having fewer than 500 employees. SMALL BUSINESS ADMINISTRATION, OFFICE OF THE CHIEF COUNSEL FOR ADVOCACY, FREQUENTLY ASKED QUESTIONS 1 (2016) [hereinafter Advocacy FAQ], available at https://www.sba.gov/sites/default/files/advocacy/SB-FAQ-2016_WEB.pdf.

¹⁸ In 1978, there were 12 new businesses created for each existing business, while in 2011 there were only 6.2 new firms created for each established business. IAN HATHAWAY, MARK E. SCHWEITZER, AND SCOTT SHANE, FEDERAL RESERVE BANK OF CLEVELAND, THE SHIFTING SOURCE OF NEW BUSINESS ESTABLISHMENTS AND NEW JOBS 2 (2014), available at <https://www.clevelandfed.org/newsroom-and-events/publications/economic-commentary/2014-economic-commentaries/ec-201415-the-shifting-source-of-new-business-establishments-and-new-jobs.aspx>.

¹⁹ According to the Federal Reserve, the Great Recession lasted from December 2007 until June 2009. https://www.federalreservehistory.org/essays/great_recession_of_200709. 1 UNITED STATES DEP'T OF LABOR, BUREAU OF LABOR STATISTICS, ENTREPRENEURSHIP AND THE UNITED STATES ECONOMY, QUARTERLY ESTABLISHMENTS BIRTHS AND DEATHS, 1993-2015 (2016), available at https://www.bls.gov/bdm/entrepreneurship/bdm_chart5.htm.

²⁰ ECONOMIC INNOVATION GROUP, THE NEW MAP OF ECONOMIC GROWTH AND RECOVERY (2016) [hereinafter EIG Map], available at <http://eig.org/recoverymap#mapBusiness>.

²¹ This number was calculated using the June 1992 population of 256 million and the June 2010 population of 309 million. <http://www.census.gov/data/datasets/2016/demo/popest/nation-total.html>, <http://www.census.gov/data/datasets/time-series/demo/popest/intercensal-1990-2000-national.html>.

²² EWING MARION KAUFFMAN FOUNDATION, KAUFFMAN INDEX ENTREPRENEURSHIP SERIES (2017), available at <http://www.kauffman.org/kauffman-index/profiles?loc=US&name=united-states&breakdowns=startup-activity|overall,main-street|overall,growth|overall#indicator-panel-se-index>.

²³ *Id.*

²⁴ *State of the Small Business Economy: Hearing Before the H. Comm. on Small Business*, 115th Cong. (2017) (testimony of Victor Hwang), available at <https://www.govinfo.gov/content/pkg/CHRG-115hrg24071/pdf/CHRG-115hrg24071.pdf>.

IV. Entrepreneurship and Economic Indicators

Entrepreneurship has a pronounced positive effect on economic growth and other primary economic indicators. One of the first individuals to make the connection between entrepreneurship and economic growth was famed 18th century economist, Adam Smith, who said that entrepreneurship would lead to an increase in innovation, productivity, and economic growth.²⁵ Although Adam Smith's theory was published back in 1776, the correlation between entrepreneurship and economic growth can be seen in the United States today. In 1997, the number of businesses less than one year old per capita was ten percent higher than in 2015.²⁶ Although the GDP growth rate was an impressive 4.5 percent in 1997, the decline in business formation coincided with an anemic GDP growth rate of 2.6 percent in 2015.²⁷

The connection between entrepreneurship and innovation also holds true today. According to a report issued by the Small Business Administration Office of Advocacy, in 2002 small businesses invented and managed an average of 10.01 products, and large businesses invented and managed an average of 21.44 products.²⁸ Although larger businesses invented roughly twice as many products, the products-to-employee ratio was significantly higher for small businesses than their larger counterparts. In terms of the number of patents obtained per dollar spent on research and development (R&D), small/young businesses obtained 2.41 times more patents than large/young businesses for every dollar spent on R&D, and small/young businesses obtained 2.5 more patents than small/old businesses.²⁹ This means that larger and older businesses have to invest more in research and development to produce the same amount of innovation as smaller and younger businesses.

Entrepreneurship is also a primary contributor to job creation. Business startups account for about 20 percent of gross job creation, and high-growth businesses account for almost half of gross job creation in the United States.³⁰ Furthermore, with small businesses accounting for 63 percent of net new job creation, it is the younger and smaller businesses that propel not only economic growth and innovation, but also job growth in the United States.³¹

V. 10,000 Small Businesses Program Overview

Goldman Sachs' *10,000 Small Businesses* is a private sector initiative to help entrepreneurs create jobs and economic opportunity by providing greater access to education, capital and business support services. To date, *10,000 Small Businesses* has served over 6,700 small businesses across

²⁵ Randall G. Holcombe, *Entrepreneurship and Economic Growth*, MISES INSTITUTE, QUARTERLY JOURNAL OF AUSTRIAN ECONOMICS (July 30, 2014), available at <https://mises.org/library/entrepreneurship-and-economic-growth>.

²⁶ This number was calculated by using the number of businesses established in 1997 (639,114) and in 2015 (679,072) divided by the population in the United States during that time (272,647,000 in 1997 and 322,060,000 in 2015). Startup Statistics, *supra* note 1. UNITED STATES CENSUS BUREAU, UNITED STATES POPULATION CLOCK, (2017) available at <https://www.census.gov/popclock/>.

²⁷ NATIONAL ECONOMIC ACCOUNTS, BUREAU OF ECONOMIC ANALYSIS, U.S. DEP'T OF COMMERCE, (2017) available at <https://www.bea.gov/national/>.

²⁸ JOSE PLEHN-DUJOWICH, PRODUCT INNOVATIONS BY YOUNG AND SMALL FIRMS, SBA OFFICE OF ADVOCACY 11 (2013), available at <https://www.sba.gov/sites/default/files/files/rs408tot.pdf>.

²⁹ *Id.*

³⁰ Ryan Decker, John Haltiwanger Ron Jarmin & Javier Miranda, *The Role of Entrepreneurship in US Job Creation and Economic Dynamism*, J. OF ECON. PERSPECTIVES 28:3 (2014), available at <http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.28.3.3>.

³¹ Advocacy FAQ, *supra* note 6.

the United States in cities such as Baltimore, Chicago, Cleveland, Dallas, Detroit, Houston, Long Beach, Los Angeles, Miami, New Orleans, New York, Philadelphia, Providence, and Salt Lake City.

The program has also reached small businesses through a National Cohort Program at Babson College, including businesses from all 50 states, Puerto Rico and Washington, D.C. The national cohort is delivered twice annually to businesses from all 50 states that are located beyond reasonable driving distance of the local sites. Under this model, small business owners accepted into the program participate in a 12-week program that is delivered through a combination of in-person and online learning.

In addition, Goldman Sachs' *10,000 Small Businesses* has dedicated over \$185 million in capital and provided approximately \$30 million in grants to over 30 partners nationwide. To date, *10,000 Small Businesses* has deployed over 1,100 loans to more than 1,000 additional businesses. Through the program, Goldman Sachs lends directly to mission-driven small business lenders and couple that investment with grants for loan loss reserves and capacity building. In addition, in partnership with Opportunity Finance Network, the program provides hands-on training and peer learning opportunities for a larger group of small business lenders committed to growing the size of their small business portfolios.

Stimulating Small Businesses Growth, a report released in 2016 from lead *10,000 Small Businesses* academic partner Babson College, found that program results are strong, with the percentage of businesses increasing jobs and revenues rising over time and outpacing the growth reported by United States small businesses generally.³² Additionally, the report found that approximately 70 percent of participants increase revenues just six months after graduation, which rises to 74 percent after 18 months and 82 percent after 30 months. Further, approximately 50 percent create net new jobs just six months after graduation, which rises to 56 percent after 18 months and 61 percent after 30 months. The program maintains a 99 percent graduation rate and 85 percent of participants work with other participants.

VI. Conclusion

Access to capital remains one of the most critical factors in the commencement and continued growth of small firms. While the country at large has seen recent improvements in economic indicators, access to capital, particularly in largely urban and predominately rural areas, lags behind. This inequity leads entrepreneurs in those areas to utilize more of their own savings and other more risky means of financing than those in more affluent regions of the country. Private sector resources, such as Goldman Sachs' *10,000 Small Businesses* program, are helping entrepreneurs gain a firm understanding in techniques to expand their businesses.

³² <http://www.goldmansachs.com/citizenship/10000-small-businesses/US/news-and-events/10ksb-impact-report-2014/program-report.pdf>.