

III. Small Business and Economic Development

Overview

Americans have a love affair with small businesses. It's been a long and passionate affair, and there's no sign of a break-up on the horizon. A poll by the Pew Research Center found the public had a more positive view of small businesses than churches or universities – in fact, more positive than any other institution. A 2014 Gallup poll showed the confidence level of Americans for small business trailed only the military among U.S. institutions. Here are the poll results:

Confidence in U.S. Institutions (June 2014 Gallup.com)
Figures are the percentage with "a great deal" or "quite a lot" of confidence

	Current	Historical	Difference
	%	%	%
Military	72	68	4
Small Business	67	63	4
Police	52	57	-5
Organized religion	42	55	-13
Medical system	37	38	-1
Presidency	33	43	-10
U.S. Supreme Court	32	44	-12
Public schools	31	40	-9
Banks	28	40	-12
Organized labor	24	26	-2
Newspapers	24	32	-8
Criminal justice system	23	23	0
Big business	21	24	-3
Television news	21	30	-9
Congress	8	24	-16

Americans felt an *increased* level of confidence for only two institutions: the military and small business. Americans had eight times (eight times!) more confidence in small business than Congress, which also showed the biggest decline in confidence from historical levels; of course, who would really be surprised by *that*.

Why do Americans love small businesses so much? There are lots of theories; here are some.

1. They're the American dream. (*Hard work + gumption = success.*)
2. They're underdogs. (*Americans love underdogs.*)
3. They're the backbone of the middle class. (*Everyone loves backbone.*)
4. They're honest and ethical. (*They're not Enron.*)
5. They grow into big firms. (*Big oak trees from little acorns grow.*)
6. They're the way up for women, minorities and the disadvantaged. (*Good!*)
7. They create most of the new jobs. (*Kind of true.*)
8. There're lots of them. (*Undeniably true.*)
9. A majority are home-based businesses. (*Who doesn't like home?*)
10. They're our neighbors. (*Good morning, Neighbor!*)
11. Lots of Americans are employed by small businesses. (*Yep, true.*)

Sometimes It Lasts In Love But Sometimes It Hurts Instead

Like most love affairs, there is perception – and then there’s reality.

When most Americans think of small businesses they think of small Mom & Pop firms with fewer than 10 employees. Those firms are small businesses – very small. In fact, they have their own classification: microbusinesses, defined as less than 10 employees. “Small business”, on the other hand, is defined (by the SBA) as firms with less than 500 employees – although many Americans would probably consider firms with 100-500 employees as medium or even large businesses.

According to U.S. Bureau of Labor (BLS) statistics, there are over 28 million small businesses in the U.S. The Harvard Business Review recently took a crack at identifying the four major segments of the small business community, and its designations are helpful:¹

TYPES OF FIRMS	NUMBER OF FIRMS	DESCRIPTION
Non-employee businesses	23 million	Sole proprietorships
Main Street	4 million	Local firms – “Mom and Pops”
Suppliers	1 million	Suppliers to other businesses
High Growth	200,000	Fast-growing, innovation-driven

Almost 23 million (82%) of the over 28 million small businesses are sole proprietorships – typically one-person firms, such as graphic designers, painters, “consultants” or direct sales representatives (think Amway). How are they doing? About 8 million of these self-employed have annual earnings less than \$10,000.²

Some other numbers:

- Small businesses (<500 employees) are 48% of national employment and 41% of payroll.
- Less than 50% of small businesses survive after 5 years, only 33% after ten.
- 52% are home-based and 2% are franchises.
- 87% of firms have less than 4 employees after 1 year.
- Small business (<500 employees) is 50% of LA County employment and 44% of payroll.
- 29% are women owned and 21% are minority owned.
- Among small business tech start-ups, 92% fail within 3 years.
- Failure rate for independent restaurants is 59.4%; for independent retailers 80%.
- About 40% of jobs initially created by start-ups are eliminated by business exits.

What small businesses have the best rate of success after 5 years (in ranked order)?³

1. Religious organizations
2. Apartment building operators
3. Vegetable crop producers

¹ “The 4 Types of Small Businesses, and Why Each One Matters”, Karen Mills, Harvard Business Review April 2015.

² <https://www.sba.gov/content/small-business-facts>

³ “Businesses with Best Rate of Success After Fifth Year”, Statisticbrain.com, (Source: Entrepreneur Weekly, Small Business Development Center, Bradley University, University of Tennessee Research), January 24, 2016.

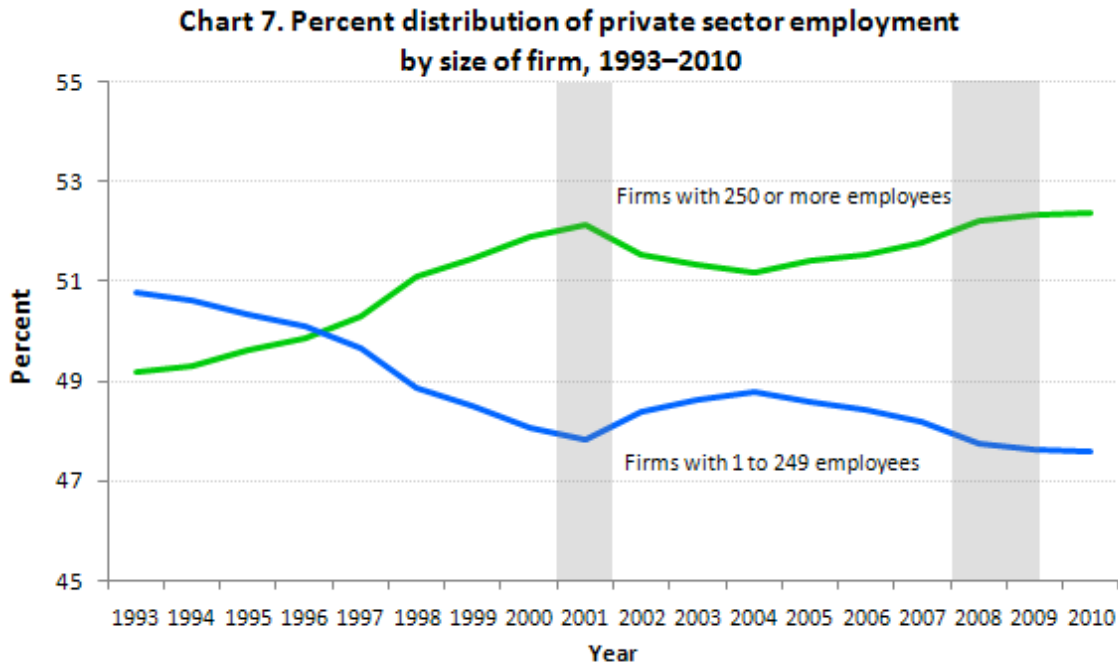
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4. Offices and clinics of medical doctors
5. Child care services

What small businesses have the worst rate of success after the fifth year?

1. Plumbing, heating, air conditioning firms
2. Single-family housing builders
3. Grocery stores
4. Restaurants
5. Security brokers and dealers
6. Local trucking

BLS tracks small business data (along with the Census and SBA). It found that firms with 249 employees or less had “seen their shares of private sector employment decrease since the early 1990s.” The following chart tracks employment distribution by firms with over 250 (Green!) and less than 249 (Blue!):



Source: U.S. Bureau of Labor Statistics

The end-date for the data/chart is 2010, two years after the close of the Great Recession and when the nation was still in early recovery. Ideally, we’d be looking at data ending in 2015. But the trend is evident – smaller firms (<250) were employing a lower percentage of private sector employment.

Voted Off the Island

Some of the numbers most tossed around about small business involve the “survival rate”. The term refers to the percentage of firms that remain in business after a period of time. Sometimes the term is “fatality rate”, and using the right number is often problematic for people. Rand Paul,

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the Senator from Tennessee, stated in 2014 that “nine out of 10 businesses fail.” That number is wrong – and if any politician should appreciate the right number it should be Senator Paul, who started his own successful ophthalmology practice (a small business!) in 2007.

The SBA number is (let’s assume they know): 48% of small businesses “survive” after 5 years and 33% after ten. So, after five years 52% of small businesses “fail”; by ten years it’s 67%.

The words describing small business start-ups and exits are also problematic. “Survival” and “failure” both have negative connotations. It would be better – at least more neutral – to think of businesses that exist/don’t exist. Not all businesses “fail” – meaning, they don’t survive in the marketplace. There are many reasons why businesses stop existing, and some have nothing to do with how successful or unsuccessful an enterprise is. According to the SBA, about 33% of new businesses fail financially but about 17% are voluntary shutdowns. Businesses can cease to exist for any number of reasons:

- Formation of a new business entity (replacing the original)
- Retirement
- Served its purpose
- Project completion
- Relocation
- Lost interest

In the “Project Completion” category, it should be noted that many real estate and development projects use a Limited Liability Corporation (LLC) legal structure. In these cases, LLCs are created for and tied to a specific project, and when the project is completed or sold, the LLC may cease to exist. That isn’t a business failure; it’s a case of “project completion” and/or “served its purpose.”

It’s Job Creation, Stupid!

For several decades, it’s been the conventional wisdom that small business is the job creation engine of the American economy. This concept started with a 1979 MIT⁴ study that stated that firms with fewer than 100 employees created 82% of the jobs in the U.S. between 1969 and 1976. That study has had an enormous impact on policy makers and economic development activities, and jump-started the premise that small business was the engine of American economic growth.

But, it’s complicated. Follow on studies questioned some of the MIT findings. Economists began to recalculate the data, and determined that small businesses do, in fact, create oodles of jobs -- but since these firms have a significant failure (exit!) rate, so there is also oodles of job destruction. (As the firm ceases to exist so too do its jobs.) It was really a question of gross job creation versus net job creation (created jobs minus destroyed jobs = net jobs.) The pendulum swung the other way: “a common confusion between net and gross job creation distorts the overall job creation picture and hides the enormous number of new jobs created by large employers.”⁵

⁴“The Job Generation Process”, David Birch, MIT Program on Neighborhood and Regional Change, February 1979.

⁵ “Are Small Businesses the Biggest Producers of Jobs?”, Kevin L. Kliesen, Julia S. Maues, Federal Reserve Bank of St. Louis, 2011.

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The Federal Reserve Bank of St. Louis prepared a comprehensive analysis of small business job creation by looking at the nation's job growth over an 18-year period using BLS statistics.⁶ They adjusted the data for the severity of the Great Recession. Here is a table that breaks out the findings concerning Gross Job Gains and Net Job Gains by firm size:

Firm Size	Gross Job Gains	Net Job Gains
1 to 19	29.3%	16.1%
20 to 99	26.8%	23.1%
100 to 499	17.8%	21.2%
500 or more	26.1%	39.4%

The table shows that when you adjust for job destruction (jobs lost when firms disappear) and use the net figure, the record for small business job creation is sizeable – but far less than the 82% that was indicated in that first MIT study. As the study concluded:

“When one accounts for job destruction, small businesses appear to account for a significantly smaller share of net new jobs created in the private sector than many people might believe.”⁷

What this all means is that if you add up the total net job gains for firms fewer than 500 employees (the SBA definition), then small businesses are responsible for about 60% and large businesses about 40%. That's still impressive.

But there's more.

Size Doesn't Matter?

As economists started looking more closely at the data they found some other wrinkles. It turns out that it's the *age* of the firm, not its size, which really matters. And job creation numbers are hugely influenced by a small number of really fast growing firms – the so-called gazelles.

The Kauffman Foundation is perhaps the nation's largest nonprofit devoted to economic development. It has been a major supporter of entrepreneurship activities with research, training and programs. (Long Beach City College administers a Kauffman funded tech seed capital program.) A recent study plowed through SBA and Census data and concluded:⁸

“New businesses account for nearly all net new job creation and almost 20 percent of gross job creation, whereas small businesses do not have a significant impact on job growth when age is accounted for.”

Other studies have confirmed this. A comprehensive NBER study looked at job creation between 1992 and 2005. Its conclusion: “The younger companies are, the more jobs they create,

⁶ Ibid.

⁷ Ibid.

⁸ “The Importance of Young Firms for Economic Growth”, Jason Wiens and Chris Jackson, Ewing Marion Kaufman Foundation, September 2015.

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regardless of their size” and “the real driver of disproportionate job growth is not small companies, but young companies.”⁹

And it’s not just age. The overall job creation numbers are heavily influenced by a small number of firms that grow very, very fast.

A study in 2008 found that less than 3% of all businesses are high growth businesses or “gazelles” but these firms were responsible for 20% of gross job creation.¹⁰ Another study (from MIT, again) looked at job creation in the state of Massachusetts and found that 5% of firms created 77% of job growth.¹¹

And from McKinsey & Co there is this:

“While the small-business universe is vast, its real economic impact comes disproportionately from a much smaller subset of high-growth firms.”¹²

So what does this all mean?

- There’s an awful lot of churning in job creation with small businesses.
- Perceptions about survival rates and job creation are often not accurate.
- The vast majority of small businesses are not major job creators.
- Small businesses are very important – but a small percentage of the total are the big job creators.

Help Is On The Way

If small businesses create jobs (and they do), and they have a high exit rate (and they do), why aren’t there programs to help them succeed?

There are – lots of them. The largest, of course, is the SBA, a federal agency created in 1938 specifically to assist small businesses. The SBA offers technical assistance to businesses and a wide variety of loan programs: general small business loans (7a); microloans, real estate and equipment loans (504); surety (completion) bonds; disaster loans; and innovation funding (SBIC). In 2015, SBA approved over \$23 billion in loans to American businesses through its various programs.

SBA also offers a wide variety of technical assistance and training programs to firms, both directly and on-line. Direct programs include the Small Business Development Center initiative, a nationwide program that provides training and one-on-one assistance to businesses through local

⁹ “Who Creates Jobs? Small vs. Large vs. Young”, John Haltiwanger, Ron Jamin and Javier Miranda, NBER Working Paper No. 16300.

¹⁰ “High-Impact Firms: Gazelles Revisited”, Zoltan Acs, William Parsons and Spencer Tracy; Corporate Research Board, 2008.

¹¹ “Nowcasting and Placecasting Entrepreneurial Quality and Performance”, Jorge Guzman, Scott Stern, NBER Working Paper No. 20954, February 2015.

¹² “Restarting The US Small Business Growth Engine “,John Horn and Darren Pleasance, McKinsey & Co, 2012.

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offices. (Long Beach City College is the regional head for the Los Angeles, Ventura and Santa Barbara SBDC program.) Other programs with local offices include:

- Disaster Field Offices
- SCORE
- Women's Business Center
- U.S. Export Assistance Center
- Veteran's Business Outreach Centers
- Regional Innovation Clusters
- Procurement Technical Assistance Centers

SBA offers over 50 on-line courses and training in a myriad of business topics, from choosing a business structure to business law to "Taking Your High-Tech Product to Market". Its web site has five pages of training topics that business owners can access with a click – and all are free.

The SCORE program has served over 10 million small businesses through 320 nationwide chapters and 11,000 volunteer mentors. Its website offers training modules ranging from Finance to Technology to Marketing.

Cities often have created their own small business assistance efforts, sometimes in conjunction with local SBDCs and sometimes as stand-alone efforts. For example, Long Beach has its own loan programs for small businesses and in the past has provided training and outreach efforts. There are also programs available to businesses from the County, the State and various nonprofit organizations. In Long Beach, a number of Business Improvement Districts have provided their own business information and assistance programs.

From access to capital to business plan development, there are numerous technical assistance programs available to small businesses at little or no cost. All are designed to help individuals start businesses and to assist existing businesses succeed. How successful all these programs are is another question.

There is no shortage of entities that promote and advocate for small business, and providers of services – both locally and nationally – are able to cite lots of data that supports their efforts. Most of the data, however, is "process" data: number of firms assisted, number of loans, amount of loans, etc. There has not been a good deal of vigorous evaluation of "impact" data, meaning: increase in revenue, increase in profits, increase in survivability, etc. One study on business assistance programs by the Rand Corporation concludes:¹³

"Our literature review shows that research on small business assistance programs lags far behind the proliferation of the programs themselves. In particular, the quality of existing evaluations in terms of their ability to measure the causal effects of programs on business outcomes is, in many cases, unsatisfactory."

A cynic might also ask: if an entrepreneur can't figure out how to get a business licensed and permitted, how likely is that entrepreneur to manage a successful enterprise and all that entails?

¹³ "Small Business Assistance Programs in the United States: An Analysis of What They Are, How Well They Perform, and How We Can Learn More about Them", Qian Gu, Lynn A. Karoly, Julie Zissimopoulos, Rand Corporation, 2014.

Every Person Their Own Entrepreneur?

A concept that has generated considerable enthusiasm with many economic development policymakers and practitioners is that entrepreneurship and small business growth are the answers to declining employment in some traditional sectors, such as manufacturing. The thought is that entrepreneurship and additional small business development will provide the employment opportunities for many in our changing economy. And perhaps one of them will be the next Apple.

This initiative is sometimes called “economic gardening”. Here is a good summary of the concept from the International City/County Management Association (ICMA):¹⁴

“Economic gardening is an entrepreneurial approach to economic development that seeks to grow the local economy from within. Its premise is that local entrepreneurs create the companies that bring new wealth and economic growth to a region in the form of jobs, increased revenues, and a vibrant local business sector.”

Interestingly, the impetus for the economic gardening movement was that same MIT study on small business job creation whose conclusions have been under revision for some time.¹⁵ In 1987, the Denver suburb of Littleton faced an economic black hole when defense contractor Martin Marietta (today Lockheed Martin) left town, laying off 7,800 people and leaving 1 million square feet of empty industrial and warehouse space. (*Does this story sound familiar to Long Beach?*) The City worked with a Denver think tank and adopted a policy (based on the MIT research) of encouraging “Stage 2” firms to locate in Littleton. Stage 2 firms were defined as having 10 to 100 employees with revenue of at least \$1 million. They called the effort “economic gardening.”

The effort was successful in Littleton. Over a 25-year period the number of jobs tripled. The city’s lead staff member for the project then left to establish the National Center for Economic Gardening, hosted by the Michigan-based Edward Lowe Foundation.

The concept of economic gardening has morphed a bit, and now focuses on entrepreneurship. The idea is that entrepreneurship creates small companies and small companies grow the economy; therefore, to grow the local economy, you should concentrate on efforts that encourage entrepreneurship.

The concept is based on the premise that entrepreneurship can be taught. But the research here is not altogether convincing. The Gallop organization has spent considerable time looking at this proposition and found:¹⁶

“Many experts do believe that you can take anyone and make that person into a super-successful entrepreneur. Unfortunately, that’s really not the case. Providing someone with

¹⁴ “Seven Steps to Developing an Economic Gardening Development Strategy”, Christine Hamilton-Pennell, InFocus, September 16, 2010.

¹⁵ “Economic Gardening is Growing But What Is It?”, Liz Farmer, Governing, June 27, 2014.

¹⁶ Gallup.com

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training and support can ignite whatever entrepreneurial capacity the individual has, but it cannot make the person creative or turn him or her into a risk-taker or into an achievement-oriented person.”

Defining the characteristics of a successful entrepreneur is something of a cottage industry. Here is just a sampling of articles on the subject, in no particular order:

- “25 Common Characteristics of Successful Entrepreneurs”, Entrepreneur.com, Article 200730.
- “The 7 Traits of Successful Entrepreneurs”, Entrepreneur.com. Article 230350.
- “8 Traits of successful entrepreneurs”, mdba.gov.
- “10 Characteristics of Successful Entrepreneurs”, Investopedia.com.
- “Top 5 Characteristics of a Successful Entrepreneur”, Iplanner.net.

Whether it’s eight or five or ten or 25 characteristics (bet it’s never 13), there are commonalities and agreement on some basics: A successful entrepreneur requires a particular skill set. In alpha order, here’s of list of just some of the talents and characteristics that entrepreneurship mavens think contribute to success:

Adaptability
Attention to Detail
Big Picture Thinking
Confidence
Dedication
Delegator
Determination
Discipline
Disrupter
Doubt
Flexibility
Hard work
Independence
Intelligence
Judgment
Knowledge
Market Understanding
Money Management
Motivation
Networking Ability
Outside the Box Thinking
Passion
Planning
Profitability Awareness
Risk-Taking
Self-Awareness
Self-Belief
Selling

Social Awareness

No problem teaching all of these!

The second issue with the entrepreneurship vein of economic gardening is that it focuses on start-ups – but the success in Littleton (remember, that was Ground Zero for the economic gardening movement) was based on companies with “at least \$1 million in annual revenue.” Adjusted for inflation, that \$1 million revenue in 1987 is now \$2,096,232.39 in 2016¹⁷. By any definition, a firm with annual revenue of \$2 million is not a start-up; it’s a well-established firm with lots of things already in place: management, sales, financial systems, operations, supply chain, etc.

On a Positive Note . . .

Small business is a really, really important component of any local economy. It just stands to reason that assisting small business should be an economic development priority because it:

- Creates jobs
- Contributes to social equity
- Enhances neighborhood vitality
- Assists women and minorities
- Helps new immigrants
- Grows the local economy

And then there is this: because it’s something cities can do. City staffers (any city, any staffer) are not likely to be able to provide professional, consulting-level expertise to major corporations in any area (save something such as zoning regulations or the like). But helping residents start new businesses – that’s doable. That assistance can be making information more readily available, providing financial support to business assistance organizations and/or (and most importantly) streamlining a city’s licensing, permitting and approval processes, a task about which no one could argue.

The very real conclusion is self-evident: encouraging and supporting a thriving small business environment will create a good return on investment. Even if small businesses do churn jobs, and a vast majority are sole proprietorships, and over half disappear within five years, it’s still worthwhile. It’s not the economic development silver bullet, but a small business support initiative should be a key component of the Long Beach economic development strategy.

Recommendations

Here is what often happens with cities and small business, in the Shakespearian five-act play structure:

- | | |
|------------|--|
| Act One: | Businesses become frustrated with city procedures. |
| Act Two: | Cities recognize the value of small business. |
| Act Three: | Cities decide to help small businesses. |

¹⁷ CPI Inflation Calculator, Bureau of Labor Statistics, <http://data.bls.gov/>.

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- Act Four: Cities get into the business assistance business with websites, seminars, workshops, loan programs, conferences, business assistance offices, etc.
- Act Five: Businesses remain frustrated with city procedures, etc.

Without fail, the larger the city, the more difficult the small business licensing, permitting and approval process usually is. Cities recognize the problem – and want to do something about it. A solution for many is to create business assistance centers. For example, the City of Los Angeles has established a network of eight Business Resource Centers. Here is what those centers do, according to the City's website:

Consulting (marketing, business plan development, site location, lease negotiation, legal structures, procurement assistance), financing (loan qualifications, credit repair, loan packaging, financial restructuring, financial planning, SBA loans, hiring (outplacement, retention strategies, organizational assessments), tax incentives and business courses.

All of that may be great. But what's the most helpful thing cities can actually do for small business? *Concentrate on taking care of their own business* by making licensing, permitting and approvals fast, seamless and painless. For example: We've been living in the age of the Internet for almost 25 years yet in the vast majority of cities, businesses still can't apply for a business license online.

Cities are moving in that direction. The SBA's "Start-Up In A Day" initiative "aims to make it easier for entrepreneurs to start a business by reducing the amount of time it takes to register and apply for permits and licenses on the local level." Long Beach has received a \$75,000 grant from SBA to put in place an online tool that would allow most small businesses to identify and apply in one day for all the requirements to open a firm in the City. On May 5, the City announced plans for a site where businesses could "obtain all the information they need – including licenses, permits and inspections – to open a new business."¹⁸ The City of Los Angeles has opened its own "start-up in a day" portal in beta mode; it's located at business.lacity.org.

What steps should Long Beach take to support small business development?

- Make business licensing, permitting and approval processes for small businesses fast, seamless and painless – and online as much as possible.
- Support existing business assistance providers and networks.
- Avoid the temptation to establish its own business assistance apparatus. Instead, focus its resources on internal process improvement.

¹⁸ "Long Beach hoping to make opening a business easier", Andrew Edwards, Long Beach Press Telegram, May 5, 2016.