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Very Basic Guide to the Small Business Sector

Each of the five Integration Initiative sites has made fostering small business a part of its strategy. From protecting immigrant-owned businesses from the effects of transit construction to seeking ways to encourage the flow of capital to minority-owned businesses to connecting local businesses to anchor institutions, sites have considered how The Integration Initiative (TII) can make a difference to the success of the small business sector. The following provides an overview of why small businesses are important to regional economies, a framework for thinking about the types of small businesses, and some suggestions for practitioners about how to think about supporting the growth of small businesses.

Small Business Matters

This emerging focus on small businesses in TII is appropriate considering the pivotal role that small businesses play in the economy:

1. **Jobs** - The vast majority (almost 99%) of all US firms are small businesses. They employ half of the private sector workforce and are the source of most net new job creation
2. **Place-making** – Small businesses like restaurants and specialty retailers can contribute to the vibrancy of a place by providing needed goods and services, generating foot traffic , and helping define the identity of a neighborhood by catering to unique niches such as minority or immigrant communities (e.g. Seattle's International District, Boston's Little Italy)
3. **Municipal tax base** – through sales and income tax, small businesses support the provision of essential public services
4. **Wealth creation** – small businesses can increase personal income and wealth. For example, women-run households have average family incomes that are less than half of the national average. Yet, in 1998, the average income of female-headed households with a business was $60,892, compared to an average of $23,941 for female-headed households without a business. Additionally, small business can help generate community wealth by capturing economic activity that would otherwise occur outside of the community.

Small Business Segmentation

The label "small business" applies to a wide variety of enterprises. A food cart vendor, a family-owned auto parts manufacturer, an interior decorator and a bio-tech company developing new gene therapies are all small businesses. One of the challenges in understanding small businesses at a macro level is the lack of common definitions/standards. When Congress was trying to define small business, 700 different definitions were offered. For our purposes, the Small Business Administration's (SBA) definition will suffice: a small business is a firm with fewer than 500 employees.

Small businesses can be segmented along three important dimensions, each of which we will discuss in turn:

- Size
- Growth potential
- Industry cluster

Size

SNAPSHOT: SMALL BUSINESS IN THE FORMAL ECONOMY

Type	Number of Firms(millions)	Share of Total Firms	Percentage of Total Sales	Total Sales
Total firms	23.7	100 %	100 %	$18.2 trillion
Total Small firms	23.4	98.7%	41 %	$7.5 trillion
Non-employer firms	17.6	74.2%	1 %	$190 billion
Small Employers with 1-4 employees	**2.9**	**12.1%**	**5 %**	$848 billion

As the table above indicates, almost 99% of all US firms are small businesses. Most of these are in fact "very small": 74.2% are sole proprietorships with no employees beyond the owner. Of the slightly less than 6 million businesses that have paid employees, 80% have fewer than 10 employees. [1]

It is useful to segment the size of small businesses as follows:

- **Sole proprietorship (0 employees)**
- **Micro**[2]: **1 to 5 employees**
  One estimate suggests there are 25 million microenterprises in the U.S. today, representing 18 percent of all employment and 87 percent of all businesses.[3]
- **Small**: **5 to 9 employees**
- **Medium**: **10 to 49 employees**
- **Large**: **50 to 500 employees**

Growth

Rapidly growing companies are valuable sources of new employment. They tend not to generate all the capital they need in order to invest in marketing and business development and therefore require access to outside sources of financing. Slower growth companies such as neighborhood-serving retail establishments may be more stable and provide an economic backbone for communities. We suggest dividing firms into two categories:

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[1] 2008 Statistics of US Businesses
[2] Association of Enterprise Opportunity (AEO) definition
[3] Federal Reserve Bank of Dallas, Small Business and Entrepreneurship Resource Center, 2010

- **Slower growth**
  - Revenues do not grow more than approximately 20% year over year
  - Not a big source of new jobs but may be more stable
  - Firms may range from 0-500 employees; growth is not correlated with size
  - Segment includes "mom and pop" and other businesses that cater to a local or neighborhood market and are not easily scalable (e.g. auto repair shop, dry cleaner)
  - Includes businesses in slow growth or declining industries (e.g. auto parts)

- **High growth**
  - Revenues double over a four-year period
  - Firm creates a significant number of new jobs[4]
  - Includes start-ups with few employees as well as older firms with more employees
  - Weighted more toward younger firms (less than 4 years) or firms that are more than 25 years old[5]
  - Segment includes traded clusters, i.e. businesses whose products and services can be sold to other regions or globally
  - Segment includes tech companies and others in rapidly growing sectors whose products and services address new categories of demand in the marketplace

Industry

Small businesses are found in each of the over 400 principal business activity codes of the North American Industry Classification System (NAICS). Small businesses in different industries have different needs for capital and other forms of assistance. For example, food businesses and biomedical companies may both need incubator space, but a shared kitchen is vastly different than a wet lab. Start-up capital for a food business may consist primarily of the owner's personal assets, while tech businesses may need venture capital to finance risky R&D.

Some Thoughts on Strategies and Segments

As noted above, small businesses matter because they generate jobs, contribute to the vibrancy of neighborhoods, support the municipal tax base, and create wealth for their owners. Yet not all types of small businesses contribute to these impacts in the same way. The following section considers some of the variation and the implications of these differences for strategy. While this provides a starting framework, more research is recommended to fully explore and evaluate these ideas.

Job Creation

Significant job creation is concentrated in the very small segment of small businesses called "gazelles" or "high impact firms." A 2010 study by the Kauffman Foundation shows that just 1% of businesses, namely the fastest growers, generate roughly 40% of new jobs in a given year. Three-quarters of those

[4] Adopted from former Chief SBA Economist, Zoltan Acs' definition of "High-impact" firms
[5] Acs, Zoltan, "High Impact Firms: Gazelles Revisited", June 2008

businesses are less than five years old. If the goal is to grow jobs, one place to look is start-ups and young businesses, especially scalable growth businesses that are commercializing innovation.[6]

Yet, a legitimate question is: jobs for whom? Firms with fewer than 10 employees have higher shares of employees working part time, employees with a high school diploma or less education, and employees 65 years or older than larger firms. This seems to indicate that these smaller firms may be able to offer employment opportunities not otherwise available to these groups.[7] Workforce development studies show that small businesses account for a larger share of employees on public assistance, and a higher number and share of employees with lower education levels. Assistance to smaller firms may be particularly effective in generating jobs for the hard to employ.

Fostering Small Business Success

Every small business, regardless of its size, growth and sector, requires access to customers, capital, management expertise, business networks, appropriate staff, and cooperative interaction with local authorities in order to succeed. Creating an environment that delivers these elements effectively can help small businesses to thrive. The complexity comes from the fact that although all businesses need these elements, the specifics of their needs vary dramatically from segment to segment. When it comes to small businesses, one size does not fit all. Further, connecting the myriad of small businesses with these elements requires significant network building and collaboration.

We will discuss the capital needs of various segments in a separate paper. For our purposes here, it is sufficient to say that in order to assess how well a region supports its small business sector, it is critical to inventory the number and types of businesses that make the region their home, to analyze the clusters of firms and assess what is being done for each segment on these different dimensions. Some examples:

- *Customers*: Are there deliberate efforts to better connect local small businesses to potential customers such as anchor institutions and government in order to help the businesses grow? For businesses in traded clusters, are there efforts to encourage exports through business exchanges?
- *Management expertise*: Are there courses, mentors or resources available to business owners in different segments to help with issues such as accounting, financing growth or planning? Are business owners aware of these resources? How widely are they used and how effective are they?
- *Networking*: What types of networking opportunities exist to enable entrepreneurs to interact with banks, angel investors, lawyers, accountants and other professionals? Do business owners have an opportunity to interact with and learn from their peers? Recent studies have made it clear that such networks are not merely "nice to have:"

[6] President Dennis Lockhart Federal Reserve Speech on small business, November 9, 2011
[7] Headd, B. 2000- Desktop Study SMEs and Poverty Reduction, CFED 2004.

> *Social networks are important to new entrepreneurs and small business owners because the ability to access information, advice, and necessary resources is vital to the success of new firms.*[8]

- *Interaction with local authorities:* Are local authorities allies in problem-solving or obstacles to business growth? How easy is it for businesses of various types to get what they need (permits, licenses, incentives) from local government? The speed, efficiency and complexity of local regulatory processes can be indicators of a local government's responsiveness to the needs of small business[9] and this responsiveness in turn can influence an entrepreneurial climate.

A robust small business sector is an important regional asset. By generating jobs and wealth, contributing to the vibrancy of neighborhoods and enhancing the municipal tax base, small businesses play an important role in fostering successful regions that provide opportunity for all. Yet the range of small businesses is so wide—from mom and pop stores to rapidly growing tech companies—that a "one size fits all" approach to addressing critical needs for capital, customers , management support and networks, cannot be effective in fostering small business success. By understanding the particular characteristics and needs of different small business segments, regions can most effectively target their resources to the types of interventions that will be most useful.

[8] http://www.cluteinstitute.com/proceedings/2010_Dublin_EABR_Articles/Article%20309.pdf

[9] McFarland, Christiana, "Local Roles in Cultivating a Small Business Entrepreneurial Culture, National League of Cities, Nov. 9. 2011