

Office of Economic Research

Research Publications 2005

January 2006

Created by Congress in 1976, the Office of Advocacy of the U.S. Small Business Administration (SBA) is an independent voice for small business within the federal government. Appointed by the President and confirmed by the U.S. Senate, the Chief Counsel for Advocacy directs the office. The Chief Counsel advances the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. Economic research, policy analyses, and small business outreach help identify issues of concern. Regional Advocates and an office in Washington, DC, support the Chief Counsel's efforts.

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Office of Economic Research



Research Publications 2005

Office of Advocacy
U.S. Small Business Administration
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Foreword

The U.S. Small Business Administration's Office of Advocacy is the federal government's primary source for research on the importance of small businesses in the economy and for studies of policy issues relevant to small firms. This report summarizes the publications produced by the Office of Advocacy's Office of Economic Research in 2005.

Advocacy research is regularly used in magazine articles, speeches, and academic research. The Frequently Asked Questions document, for example, is often cited, and many take advantage of the timely information in our Quarterly Indicators. The office this year added value to The Small Business Economy by including more chapters from outside contributors in addition to the annual data for which it has become a reference.

Highlights of the past year included two research conferences, "Putting it Together: The Role of Entrepreneurship in Economic Development" in March that examined state-level best practices, and Global Perspective on Entrepreneurship Policy held in June in conjunction with the International Council for Small Business annual meeting. The proceedings publications documenting these conferences have been well received.

Other studies garnered significant attention in 2005. W. Mark Crain updated earlier groundbreaking research on the cost to small businesses of complying with federal regulations, finding that the cost per employee for small firms is \$7,647. Joel Popkin studied the cost of employee benefits by firm size. Karlyn Mitchell and Douglas Pearce used the Survey of Small Business Finances to examine the availability of financing to small firms. The Klemm Analysis Group looked at the small business cost of litigation. And S. Michael Camp studied the role of entrepreneurship and innovation in creating an environment where local economic growth can thrive.

All of our research and data can be found online at <http://www.sba.gov/advo/research>. For regular updates on our research as it is released, please join Advocacy's research listserv, which can be found at <http://web.sba.gov/list>. We appreciate your ongoing interest in small business.



Chad Moutray, Ph.D.

Chief Economist and Director

Office of Economic Research

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Office of Economic Research

Research Publications 2005

Small Business and Micro Business Lending in the United States for Data Years 2002-2003

Banking/Finance

Charles Ou and Victoria Williams

Data years 2002-2003, released March 2005

Data years 2003-2004, released November 2005

<http://www.sba.gov/advo/research/lending.html>

The Office of Advocacy prepares an annual study of bank lending to small firms, using the most recent data available on small and micro business loans to small firms and on the banks that serve them. This study provides a brief review of the banks' lending activities based on two types of data reported by banks to their regulating agencies—call reports and reports required by the Community Reinvestment Act (CRA). Because data are available only by the size of the loan, small business loans are defined as business loans under \$1 million and micro business loans are those under \$100,000.

Banking Consolidation and Small Business Lending: A Review of Recent Research

Charles Ou, Working Paper, released March 2005

<http://www.sba.gov/advo/research/wkp05ou.pdf>

Banking consolidation has continued to accelerate over the past several years, assisted by technological innovations in information management and statistical modeling, and by the large merger and acquisition (M&A) deals of the late 1990s. Total domestic assets held by the 50 largest bank holding companies (BHC) rose from about 52 percent in June 1997 to nearly 70 percent in June 2002, and the number of small banks with assets under \$500 million declined from 8,647 in June 1997 to 7,208 in June 2002. The perennial question about the impact of banking consolidation on the availability of financing to small business remains a major concern to small business researchers and policymakers. This paper provides a review of recent major studies conducted over the past several years.

The Effects of Mergers and Acquisitions on Small Business Lending by Large Banks

Diana Hancock, Joe Peek, and James A. Wilcox (KeyPoint Consulting LLC), released March 2005

<http://www.sba.gov/advo/research/rs254tot.pdf>

The study documents recent trends in small business lending at the largest bank holding companies (BHCs). It then provides an analysis of the effects of the recent consolidation in the banking industry on small business lending. The analysis makes key distinctions that are generally missing from the literature and estimates of small business lending. First, it distinguishes between (1) originations and purchases of small business loans and (2) the more typically used stocks of small business loans held on bank balance sheets. It then looks to see whether views about the credit available to small businesses might be influenced by the choice of the measure of lending. Second, it distinguishes between acquisitions of banks (and BHCs) and mergers of banks (and BHCs). To date, little is known about the effects on small business lending of consolidation within a BHC (the combining of bank charters through mergers), as opposed to the effects of consolidation into a BHC (the change of ownership through acquisition). By distinguishing mergers within BHC banks from bank acquisitions by a BHC, the report estimates whether small business lending is affected differently by shifts in the organizational structure of BHCs than by changes in the ownership of banks. Third, it distinguishes between the effects of internal and external growth of the largest BHCs.

Finance Companies and Small Business Borrowers: Evidence from the 1993 and 1998 Surveys of Small Business Finances

George W. Haynes, released April 2005

<http://www.sba.gov/advo/research/rs255tot.pdf>

Finance companies play an important role in providing short- and medium-term financial capital to small business borrowers. They are the most important institutional providers of capital to small businesses after banks. This study examines whether finance companies' importance in providing financial capital to small business borrowers changed during the 1990s. This is interesting because the 1990s were a decade of rapid growth in financial markets, including expansion in interstate banking and lending by both finance companies and commercial banks. This study uses the most recent data on small business finances to evaluate the importance of finance companies to small business borrowers in 1993 and 1998; to assess what types of borrowers were attracted to finance companies; and to determine if these finance company borrowers paid higher loan prices.

Availability of Financing to Small Firms using the Survey of Small Business Finances

Karlyn Mitchell and Douglas K. Pearce, released May 2005

<http://www.sba.gov/advo/research/rs257tot.pdf>

This study investigates possible restricted access to credit for minority- and women-owned businesses by focusing on two types of credit—"relationship loans" (lines of credit) and "transaction loans" (commercial mortgages, motor vehicle loans, equipment loans, capital leases, and other loans)—from two types of creditors: commercial banks and nonbank lenders. The disaggregated approach is feasible because of a rich new data set, the 1998 Survey of Small Business Finances. The results imply that minority small business owners face some restrictions in access to credit. These restrictions do not appear to be uniform across loan or lender type. This study breaks new ground by suggesting that preferential lending practices characterize the granting of transaction loans to a significantly greater degree than the granting of relationship loans.

A Spatial Model of the Impact of State Bankruptcy Exemptions on Entrepreneurship

Aparna Mathur, released July 2005

<http://www.sba.gov/advo/research/rs261tot.pdf>

The focus of this paper is on the U.S. personal bankruptcy law, and in particular, the effect that state bankruptcy exemptions have on entrepreneurship. The homestead exemption is an exemption for equity in owner-occupied housing. This varies widely among the states, with some states having no exemption and others having unlimited exemptions. Most states also have exemptions for household belongings, equity in vehicles, retirement accounts, and a wildcard category that can be applied to any type of asset. These exemption levels have changed over time in many states. Given these differences in state bankruptcy exemptions, businesses might opt for a business location based on the conditions in surrounding states. This study finds that entrepreneurs choose the location of their businesses in response to competing business conditions in and outside the state, making state bankruptcy laws a significant determinant of entry and exit decisions by small firms.

The Effect of Changes in Monetary Policy on the Expectations, Spending, and Hiring Decisions of Small Business Owners

William C. Dunkelberg and Jonathan A. Scott, released November 2005

<http://www.sba.gov/advo/research/rs267tot.pdf>

The transmission channels through which changes in monetary policy affect private sector spending and hiring are incompletely understood, especially in the small business sector. This study documents how small firms react to unexpected changes in monetary policy. Monthly survey data obtained from the National Federation of Independent Business illustrate how owner expectations are affected by these changes, with corresponding adjustments to spending and hiring plans, and ultimately changes in actual spending and hiring. Thus, the results provide some new micro level insight into how quickly changes in monetary policy work through the small business sector and ultimately the aggregate real economy. The findings indicate that the small business sector responds immediately to announced changes in monetary policy and that these changes have significant impacts on employment and prices, the two major concerns of monetary policy.

Agency Costs and Ownership Structure: Evidence from the Small Business Finance Survey Data Base

Jacky Yuk-Chow So, released December 2005

<http://www.sba.gov/advo/research/rs268tot.pdf>

Agency problems arise when a corporate organization (the principal) employs a professional manager (the agent) and thereby separates the business owner(s) from control of the business. Most previous studies of such agency problems used data from publicly traded companies. Applying these study results to small owner-controlled business reveals two limitations. First, in most publicly traded companies, the largest shareholders seldom own more than 50 percent; therefore, the results may not be applicable to problems faced by smaller, family/owner-managed firms. Second, since control is not separate from ownership, these small firms should, by definition, have no agency problem. Family shareholders usually are less likely to expropriate bondholder wealth than other shareholders; family firms may also have incentive structures that result in fewer agency conflicts between equity and debt claimants. The author hypothesizes that agency problems suffered by larger firms are not statistically significant for smaller owner-manager or family-owned firms. The Federal Reserve Board's 1993 National Survey of Small Business Finances (NSSBF) database was used to test the hypotheses.

Firm Size Dynamics of Industries: Stochastic Growth Processes, Large Fluctuations, and the Population of Firms as a Complex System

Daniel Teitelbaum and Robert Axtell (NuTech Solutions, Inc.), released January 2005

<http://www.sba.gov/advo/research/rs247tot.pdf>

With the emergence of various longitudinal data sources for firms, studies on business size distributions, business turnover, and business growth/decline have had a resurgence among the academic community. This study was conducted to better understand the dynamic nature of the growth and decline of firms in various size classes and industries. It finds that firm growth rates do not fit the often assumed normal distribution. As a result, there are more slow-growing firms, more fast-growing firms, and fewer medium-growing firms than are generally modeled by economists. This finding held for all industries analyzed and growth rates were unrelated to establishment size.

Entrepreneurial Risk and Market Entry

Brian Wu and Anne Marie Knott, Working Paper released January 2005

(Recipient of the Advocacy Best Doctoral Student Paper Award at the United States Association for Small Business and Entrepreneurship annual meetings.)

<http://www.sba.gov/advo/research/wkpbw249.pdf>

Entrepreneurs, by their nature, are risk takers. The authors of this study suggest that there are two forms of uncertainty in entrepreneurial ventures: (1) uncertainty regarding market demand, and (2) uncertainty regarding one's own entrepreneurial ability. They further propose that entrepreneurs display risk aversion with respect to demand uncertainty, but exhibit overconfidence or "risk seeking" with respect to ability uncertainty. To examine this view, the authors model the entrepreneur's entry decision; and the research shows that entrepreneurs, while risk-averse in their role as risk bearers, are willing to bear economic risk when overconfidence compensates for their aversion

Quarterly Indicators: The Economy and Small Business

Chad Moutray

Fourth Quarter 2004, released February 2005

<http://www.sba.gov/advo/research/sbqei0404.pdf>

First Quarter 2005, released May 2005

<http://www.sba.gov/advo/research/sbqei0501.pdf>

Second Quarter 2005, released August 2005

<http://www.sba.gov/advo/research/sbqei0502.pdf>

Third Quarter 2005, released November 2005

<http://www.sba.gov/advo/research/sbqei0503.pdf>

This regular publication pulls together data from a variety of sources to highlight quarterly economic trends relevant to small businesses.

Business Estimates from the Office of Advocacy: A Discussion of Methodology

Brian Headd, Working Paper, released June 2005

<http://www.sba.gov/advo/research/rs258tot.pdf>

Although many measures of the number of firms are available, adding employers and nonemployers from U.S. Department of Commerce, Bureau of the Census data sources is the best and most complete. However, this number is only available with a lag time of about two and a half years. The Office of Advocacy estimates more current figures and offers this paper to make the methodology transparent and to generate discussion.

Small Business Profiles for the States and Territories

Victoria Williams, released August 2005

<http://www.sba.gov/advo/research/profiles/>

The economic condition of small businesses in the United States, overall and in each of the 50 states, the District of Columbia, and the U.S. territories is illustrated. Each state profile contains sections on the following topics: the number of firms, industry composition, small business income, banking, women's and minority business ownership, and employment.

Frequently Asked Questions

Chad Moutray, released October 2005

<http://www.sba.gov/advo/stats/sbfaq.pdf>

This document serves as a summary of other research materials and provides a series of quick, easy-to-recite facts for an external audience to recognize the importance of small business in the economy. As such, it is an excellent "introductory" publication for individuals to acquaint themselves with Advocacy research and data.

Research Resources (an update to the Academic Frequently Asked Questions)

Chad Moutray, released November 2005

<http://www.sba.gov/advo/research/rrsb.pdf>

General Small Business and Entrepreneurship

This document addresses a number of questions about small business research and data from the perspective of a faculty member, student, or researcher. It includes a brief listing of journals and recommended readings, links to data and other web-based sources, and information about research funding.

The Small Business Economy: A Report to the President, 2005 Edition

Kathryn Tobias, ed., various contributors, released December 2005

http://www.sba.gov/research/sb_econ2005.pdf

In this fourth edition of *The Small Business Economy*, the Office of Advocacy reviews the economic environment for small businesses in the year 2004, as well as the financial and federal procurement marketplaces.

Chapter 1: “The Small Business Economy” by Brian Headd

Chapter 2: “Small Business Financing in 2004” by Charles Ou

Chapter 3: “Federal Procurement from Small Firms” by Major Clark III

Chapter 4: “Minority Entrepreneurship” by Robert Fairlie

Chapter 5: “Entrepreneurship and Business Ownership in the Veteran and Service Disabled Veteran Community” by Waldman Associates and REDA International with review by Joseph Sobota

Chapter 6: “A Discourse on Tax Complexity and Uncertainty and their Effects on Small Business” by Radwan Saade and Joseph Johnson

Chapter 7: “The Regulatory Flexibility Act: History and Current Status of RFA Implementation” by Carrol Barnes with contributions by Claudia Rodgers and Sarah Wickham

Chapter 8: “Small Firms: Why Market-Driven Innovation Can’t Get Along Without Them” by William J. Baumol

Appendix Data Tables by Brian Headd and Victoria Williams

**The Innovation-Entrepreneurship NEXUS: A National Assessment of
Entrepreneurship and Regional Economic Growth and Development**

S. Michael Camp (Advanced Research Technologies, LLC), released April 2005

(This project was co-funded by the Edward Lowe Foundation of Cassopolis, Michigan.)

<http://www.sba.gov/advo/research/rs256tot.pdf>

The connection between innovation and entrepreneurship as drivers of local economic development is often discussed but not often studied. This research addresses the needs of local policymakers to understand the role of entrepreneurship and innovation in creating an environment where local economic growth can thrive. Both entrepreneurship (new firms and growing firms) and innovation (patents, R&D, and hi-tech industries) are drivers in the growth of regional economies. This study finds that innovative regions need entrepreneurship to more fully develop local economies. Entrepreneurial regions are likely to be associated with higher levels of technology.

**Technology and Entrepreneurship: A Cross-Industry Analysis of Access to
Computers and Self-Employment**

Robert Fairlie, released June 2005

<http://www.sba.gov/advo/research/rs259tot.pdf>

Numerous studies have focused on the relationship between information technology investment and productivity, but little has been done to learn more about the role of personal computers in business creation. This report examines whether computer ownership in the home influences self-employment or entrepreneurship or the types of businesses created by entrepreneurs. Trends over the past two decades provide evidence of a positive relationship between home computers and entrepreneurship. Male and female computer owners were more likely to become entrepreneurs than non-computer owners, and the study indicates that entrepreneurs with prior access to home computers are starting many different types of businesses.

Broadband Use by Rural Small Businesses

Telenomic Research, released December 2005

<http://www.sba.gov/advo/research/rs269tot.pdf>

This research explores two popular beliefs pertaining to the deployment and use of broadband service: first, that these services provide tangible benefit to the overall

economy, and second, that rural deployment lags urban deployment. It has often been suggested that the universal provision of broadband services in rural areas is cost prohibitive, leading to the urban-rural digital divide. This study investigates and verifies these assertions, specifically, as they apply to rural small businesses. It relies primarily on data from the Federal Communications Commission (FCC) and survey data from previous Advocacy-funded research. The study finds that an urban-rural digital divide does exist in the provision and adoption of broadband services. This difference in broadband use is statistically significant. A major concern is that many benefits have been associated with the availability and adoption of broadband services, and rural small businesses are not obtaining them.

Innovation and Technology

Global Perspectives on Entrepreneurship Policy

Rebecca Krafft, ed., Conference Proceedings, released October 2005

Conference Agenda: http://www.sba.gov/advo/research/conf_summary05.pdf

Proceedings Part I: http://www.sba.gov/advo/research/proceedings_a05.pdf

Proceedings Part II: http://www.sba.gov/advo/research/proceedings_b05.pdf

Proceedings Part III: http://www.sba.gov/advo/research/proceedings_c05.pdf

On June 15, 2005, the Office of Advocacy, the National Federation of Independent Business, and the United States Association for Small Business and Entrepreneurship organized a pre-conference session at the International Council for Small Business annual meetings in Washington, DC. The panel discussions focused on public policy issues as they pertain to entrepreneurs around the world. In the sessions, participants learned about the costs of entry for a new firm, work force challenges, regulatory burdens, the importance of technology transfer and innovation, and small business financing issues from a wide variety of global experts.

International Issues and Small Businesses

Cost of Employee Benefits in Small and Large Businesses

Joel Popkin and Company, released August 2005

<http://www.sba.gov/advo/research/rs262tot.pdf>

This study examines the cost of the benefits that employers provide to their workers and how these costs vary with company size. It focuses on benefits that employers voluntarily provide: health insurance, private pension plans, paid vacation, and sick leave. Overall, the authors find that employees of small businesses have access to fewer benefits than do

Labor and Employment Benefits

Labor and Employment Benefits

the employees of large businesses. Small and large businesses continue to provide benefits to their employees, but at a declining rate. Companies of all sizes have reduced the availability of health insurance to their employees because of the increasing cost associated with benefits in recent years. Access to retirement benefits is more prevalent among large firms than among small firms.

Legal Issues and Litigation

Impact of Litigation on Small Business

Klemm Analysis Group, released October 2005

<http://www.sba.gov/advo/research/rs265tot.pdf>

Litigation costs, unlike other costs of doing business, are seldom estimated on an annual basis. This research attempts to shed light on how small business fares under the constraint of litigation and calculates annual litigation costs. It finds that the impact of litigation on businesses goes well beyond the purely financial impact of legal fees and damages. Most small business owners are invested personally in their businesses; litigation causes not just financial loss, but also substantial emotional hardship, and often changes the tone of the business. Moreover, many of the small businesses surveyed tried to settle their cases prior to trial, but with mixed results. Those surveyed explained that the main reason settlement failed was that the opposing party refused to meet and negotiate, preferring to go to court. Small business owners indicated they would go to great lengths to stay out of court, which was their major motivation for settlement; an indication that there is a hidden cost to the threat of litigation.

Owner Demographics

Dynamics of Minority-Owned Employer Establishments, 1997-2001

Ying Lowrey, Working Paper, released February 2005

<http://www.sba.gov/advo/research/rs251tot.pdf>

This report tracks the dynamics of minority-owned employer establishments that were in operation in 1997 over the period 1997-2001. The data used here track business closure, expansion, and contraction by the business owners' race or ethnicity and by their state and industry. To provide context for the discussion of business dynamics, the report also gives a summary of minority population and business growth between 1982 and 2002. It finds that minority-owned employer establishments had lower survival rates than nonminority-owned employer establishments. At the same time, minority-owned establishments had higher expansion rates and lower contraction rates than nonminority-owned establishments.

While there was an overall loss of employment due to business closures and contraction among employer establishments that were in operation in 1997, employer establishments owned by Hispanics and by American Indians and Alaska Natives contributed significantly to an increase in new jobs during the 1997-2001 period.

Owner
Demographics

U.S. Sole Proprietorships: A Gender Comparison, 1985-2000

Ying Lowrey, Working Paper, released September 2005

<http://www.sba.gov/advo/research/rs263tot.pdf>

(A shorter version of this paper was published in the Spring 2005 issue of SOI Bulletin, which can be found online at <http://www.irs.gov/pub/irs-soi/00solprop.pdf>.)

Using the 1985-2000 U.S. sole proprietorship database, tabulated by the Statistics of Income (SOI) Division of the Internal Revenue Service, this study attempts to answer several research questions. What are the growth patterns of male and female sole proprietorships? Is there any earning differential along gender lines? Is there any industrial gender segregation among business owners? The dataset provides unique information about U.S. sole proprietorships in terms of business size and owner's marital status within 10 industrial classifications, six broad industry categories, and the 10 most populous states. Overall, this research finds that between 1985 and 2000, female-owned sole proprietorships grew at a faster rate than those owned by men. Business earnings and activities are different among male and female business owners.

Using Census BITS to Explore Entrepreneurship, Geography, and Economic Growth

Zoltan Acs and Catherine Armington, released February 2005

<http://www.sba.gov/advo/research/rs248tot.pdf>

This paper discusses three related research projects that used the Business Information Tracking Series (BITS). This set of data was developed by the U.S. Bureau of the Census with support from the U.S. Small Business Administration, Office of Advocacy. The purpose of the report is to demonstrate the importance and usability of large micro databases such as the BITS that cover almost all U.S. private sector businesses, and track their employment and firm ownership annually from 1988 through 2001. Empirical results using BITS data in three studies bore out the authors' contention that models of economic growth would be substantially improved by greater incorporation of theories of entrepreneurial activity. Variation in firm formation rates (defined as the number of net new firms per 1,000 in the labor force in a particular

Regional Economic
Development

year) is substantially explained by regional differences in industry specialization, human capital, and local population and income growth rates.

The Innovation-Entrepreneurship NEXUS: A National Assessment of Entrepreneurship and Regional Economic Growth and Development

S. Michael Camp (Advanced Research Technologies, LLC), released April 2005
(This project was co-funded by the Edward Lowe Foundation of Cassopolis, Michigan.)

<http://www.sba.gov/advo/research/rs256tot.pdf>

See the description of this study in the “Innovation and Technology” section.

Putting It Together: The Role of Entrepreneurship in Economic Development

Kathryn Tobias, ed., Conference Proceedings, released June 2005

Conference Agenda: http://www.sba.gov/advo/research/conf_summary.pdf

Proceedings Part I: http://www.sba.gov/advo/research/entrep_proc.pdf

Proceedings Part II: http://www.sba.gov/advo/research/appendix_a.pdf

Proceedings Part III: http://www.sba.gov/advo/research/appendix_b.pdf

On March 7, 2005, the Office of Advocacy and the Ewing Marion Kauffman Foundation, with support from the Council of State Governments and the National Lieutenant Governors Association, convened the conference, “Putting It Together: The Role of Entrepreneurship in Economic Development,” in Washington, DC. This conference examined the “best practices” of various states to promote entrepreneurship as a means of growing their economies and featured a variety of panels to outline these initiatives. Four programs were awarded “best practices.”

State of the Inner City Economies: Small Businesses in the Inner City

Initiative for a Competitive Inner City (ICIC), released October 2005

(This paper is the result of a larger project undertaken by ICIC. Other funders for this project include the U.S. Economic Development Administration, the John D. and Catherine T. MacArthur Foundation, and the Greater Kansas City Community Foundation.)

<http://www.sba.gov/advo/research/rs260tot.pdf>

Inner city neighborhoods are often found in the economic heart of metropolitan areas. Despite their central location, they are rarely considered competitive locations for developing unique markets and creating high-wage jobs. Outdated perceptions continue to obscure their positive realities. Inner city economies are larger and more active than is generally understood, especially among the small businesses that employ the vast majority of inner city workers. The State of the Inner City Economies (SOICE) project seeks to document the impact that small establishments have in the inner city. The goal of this analysis is to present the business potential of inner cities. Inner city businesses are similar to businesses located in the rest of the metropolitan statistical area (MSA), exhibiting similar startup and bankruptcy rates. Small businesses are the greatest source of net new employment in inner cities—comprising more than 99 percent of establishments and 80 percent of total employment.

The Impact of Regulatory Costs on Small Firms

W. Mark Crain, released September 2005

<http://www.sba.gov/advo/research/rs264tot.pdf>

Regulation

This research updates and further delineates the disproportionality of the burden imposed by federal regulations on small business. Previous research by the Office of Advocacy, Hopkins (1995) and Crain and Hopkins (2001) established that regulatory and paperwork costs were more onerous on small firms than on larger firms. In the face of higher costs of federal regulations, the research shows that small businesses continue to bear a disproportionate share of the federal regulatory burden. The findings are consistent with those in the earlier studies. It also finds that the cost of federal regulations totals \$1.1 trillion; the cost per employee for firms with fewer than 20 employees is \$7,647. This report details the distribution of regulatory costs for five major sectors of the U.S. economy: manufacturing, trade (wholesale and retail), services, health care, and other (a residual category containing all enterprises not included in the other four). The sector-specific findings reveal that the disproportionate cost burden on small firms is particularly stark for the manufacturing sector.

Tax

Taxes and Entrepreneurial Activity: An Empirical Investigation Using Longitudinal Tax Return Data

Donald Bruce and Tami Gurley, released March 2005

<http://www.sba.gov/advo/research/rs252tot.pdf>

The report uses longitudinal tax return data to measure the responsiveness of individual tax filers to changes in marginal income tax rates with respect to their choices to engage in entrepreneurial activity. Individual choices to engage in wage-and-salary employment, entrepreneurial activity, or a mixture of both, are taken as given by the existence of each type of income as reported in individual income tax filings. This study finds that marginal tax rates have significant effects on entrepreneurial entry and exit, suggesting that the formation and closure of small enterprises are in part determined by the handling of income from these activities in the tax code. The findings show that the level of entrepreneurial entry, exit, and duration react differently to changes in marginal rates on wage-and-salary and entrepreneurial income. Specifically, lower marginal rates on entrepreneurial income encourage more entrepreneurial entry and lower rates of exit, and lengthen the duration of spells of activity. Similarly, higher marginal rates on wage-and-salary income also increase entrepreneurial activity as more workers switch from wage-and-salary work to starting their own businesses. Importantly, however, the magnitude of the entry, exit, and duration effect is larger for marginal tax rates on entrepreneurial income than on wage-and-salary income.

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