DECEMBER **2007**

The SMALL BUSINESS ECONOMY

For Data Year 2006

A REPORT TO THE PRESIDENT

SBA
Office of Advocacy
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Dear Mr. President:

The Office of Advocacy of the U.S. Small Business Administration (SBA) is pleased to present *The Small Business Economy: A Report to the President.* The American economy is blessed with an entrepreneurial spirit that continues to be the envy of many nations around the world. Small business leaders provide new ideas, employ additional workers, and develop innovative products and services. By investing in their businesses, the small firm owner makes a major contribution to the local, regional, and national economy.

Over the past year, the Office of Advocacy has conducted research that documents these points. First, Kathryn Kobe of Economic Consulting Services reconfirmed our knowledge that small businesses account for half of private, nonfarm gross domestic product. Second, Donald Bruce, John A. Deskins, Brian C. Hill, and Jonathon C. Rork find that a state's ability to generate new establishments is the most important factor that leads to higher gross state product, state personal income, and total state employment. Finally, Larry Plummer, a doctoral student at the University of Colorado at Boulder who served as a visiting research economist in this office, found that new business entrants provide long-term benefits to the local economy; the increased competition might be painful in the short term, but with time, collaborative efforts accrue to everyone's betterment. These and other studies can be found on the Office of Advocacy's research page at http://www.sba.gov/advo/research.

This edition of *The Small Business Economy* features two chapters on owner demographics based primarily on the 2002 Survey of Business Owners from the U.S. Census Bureau. In documenting the number of small businesses owned by minorities, women, veterans, and service-disabled veterans, we gain a better understanding of their contributions to the economy.

This report also summarizes the economic and small business financial climate in 2006, and examines small business procurement. Generally, the economy and financial markets were supportive of small business growth in 2006. The Office of Advocacy, through its implementation of the Regulatory Flexibility Act of 1980 and Executive Order 13272, has assisted small businesses by helping to reduce the regulatory compliance costs of proposed rules. For instance, in FY 2006, Advocacy's efforts resulted in cost savings of $7.25 billion in the first year and $117 million annually for small businesses. These are costs that will not be borne by the small business owners as a result of changes in the regulations they comply with.

We also feature two chapters from external contributors. Andrew Wolk of the Root Cause Institute and a senior lecturer at the Massachusetts Institute of Technology presents a number of examples of social entrepreneurship across the country and outlines steps governments are taking to promote social entrepreneurs as a mechanism for solving some of our nation's problems. Some may ask, "What does social entrepreneurship have to do with small business?" A short answer might be that social entrepreneurship exhibits many of the attributes of small business entrepreneurship, serving as an engine of innovation, job creation, and economic growth. Moreover, by bringing together aspects of the public, private, and nonprofit sectors to address a market failure, social entrepreneurs have, in a variety of ways, helped create an economic environment in which private entrepreneurs and small businesses can flourish. The longer answer may be to read on and see how this chapter answers the question. It is an excellent chapter that will provoke discussion in academic and policymaking circles.

A second chapter from external contributors, by William Gartner of Clemson University and Jianwen (Jon) Liao of the Illinois Institute of Technology, discusses the need for pre-venture planning. They find that nascent business owners who engaged in business planning during the startup phase and wrote a formal business plan were more likely to open and remain in business. In essence, they suggest that the process of drafting a business plan was essential to the overall success of the venture. While that might seem common sense to many, a debate in recent years has sometimes challenged the need for pre-venture planning as a prerequisite for success. This chapter lends credence to those who suggest that planning matters.

In sum, the 26.8 million small businesses in the United States play a vital role in the economic well-being of our nation. The research of the Office of Advocacy continues to document the importance of the entrepreneur in maintaining economic growth, employing workers, bringing new innovations to the marketplace, and remaining competitive in a global economy.

Chad Moutray

Chief Economist and
Director of Economic Research

Acknowledgments

The Small Business Economy: A Report to the President was prepared by the U.S. Small Business Administration, Office of Advocacy. The Chief Counsel for Advocacy is Thomas M. Sullivan; the Chief Economist is Chad Moutray. The project was managed by Senior Editor Kathryn J. Tobias. Specific chapters were written or prepared by the following staff and outside contributors:

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The Office of Advocacy appreciates the interest of all who helped prepare the report. Special thanks to Rebecca Krafft for editorial assistance. Thanks are also extended to the U.S. Government Printing Office for their assistance.

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Executive Summary

The Small Business Economy 2007 reviews how small businesses fared in the economy in 2006, in the financial markets, and in the federal procurement marketplace, as well as new information about minorities and veterans in business. Chapters 6 and 7 offer guest contributors' studies of social entrepreneurship and pre-venture planning. In Chapter 8, with its responsibility for oversight of Regulatory Flexibility Act implementation, the Office of Advocacy takes a look at the regulatory environment for small firms. Appendices provide additional data on small businesses and background information on the Regulatory Flexibility Act.

The Small Business Economy in 2006

Small businesses continued to be at the core of the continuing economic expansion in 2006. Output rose, business income and profits were up, and unemployment was down. The estimated number of firms and self-employed individuals increased. Output declined from a high in the first quarter, and early 2007 indicators also portrayed a slight slowing of the economy.

Small businesses continued to drive employment in early 2006. The overall employment increase of 2.3 percent was low relative to other periods, but occurred in the context of a tightening labor market as unemployment declined to 4.6 percent.

In 2004, the most recent year for which firm size data are available, small firms with fewer than 500 employees accounted for all of the net new jobs. According to the U.S. Department of Commerce, Bureau of the Census, firms with fewer than 500 employees had a net gain of 1.86 million new jobs, while large firms with 500 or more employees had a net loss of 181,000 jobs. Small firms employed just over half of the private sector work force and generated more than half of nonfarm private gross domestic product. More than 99 percent of American businesses are small, and the average small employer had one location and 10 employees, compared with 62 locations and 3,313 employees in the average large business.

The report reviews data on the costs of doing business for small firms. A 2.8 percentage point decline in the small business share of payroll, from 47.9

percent in the late 1980s to 45.1 percent in 2004, mirrors a 2.9 percentage point decline in the small business share of employment. An appendix to the chapter takes a brief look at sources of data on current small business trends.

Small Business Financing

The economy continued to grow at a slower, but still healthy pace in 2006, and total business borrowing increased by one-third, from $562 billion in 2005 to $753 billion in 2006. Borrowing by the smaller, nonfarm, nonfinancial businesses declined slightly, from $304 billion to $289 billion. Nevertheless, small business credit continued to expand in 2006 because of favorable economic conditions and a financial market with ample liquidity. The most recent data available indicate that most small businesses use traditional credit, such as credit lines, loans, or capital leases for their business financing needs; most of the increases in small business financing are in credit lines and credit cards. Banks continued to consolidate, with 108 multibillion-dollar banking institutions accounting for three-fourths of total domestic bank assets, nearly two-thirds of all business loans, and 45 percent of small business loans. Equity markets increased at a moderate pace, and the average offering size in the initial public offering market increased, while the number of IPOs dropped slightly.

Federal Procurement from Small Firms

At the forefront of President Bush's Small Business Agenda have been efforts to provide greater transparency in federal small business procurement. Improvements recently implemented include new guidance for large businesses subcontracting to small firms, improvements in small business size standards, clarification of the "novation" regulations relating to small businesses acquired by larger ones, initiatives toward more transparency in federal procurement data, and steps to reduce the contract bundling that can leave small firms out of the competition.

In FY 2006, according to the U.S. Small Business Administration, small businesses received more than $77 billion, or 22.8 percent of a total of $340 billion in federal government contracts eligible for small business competition. In addition, small firms won an estimated $65 billion in subcontracts with prime contractors to the federal government, for a total FY 2006 estimated dollar value of more than $142 billion in small business contracts. The shares of federal procurement from small women-owned, disadvantaged, veteran-owned, and HUBZone businesses continued to increase in FY 2006 to 3.4 percent, 6.8 percent, 2.6 percent, and 2.1 percent, respectively.

The Small Business Innovation Research program encourages small firm innovation by requiring participating federal agencies to devote a percentage of their extramural research and development funding to small firms. A total of $19.9 billion has been awarded to small businesses over the 24 years of the program. In FY 2006, participating agencies received a total of more than 27,000 proposals and made nearly 6,000 awards totaling $1.9 billion.

Minorities in Business

Recently released information on minorities in the work force and minority-owned businesses includes minority population statistics, labor force participation, age, education, occupation, work schedules, average personal and household income, business ownership, and business dynamics. This update of previous studies on minority-owned businesses primarily uses data from the 2002 Survey of Business Owners (SBO) from the U.S. Census Bureau. Based on the 2002 American Community Survey, the total U.S. population consisted of 68.2 percent non-Hispanic Whites and 31.8 percent minorities. In 2002, minorities owned approximately 18 percent of the 23 million U.S. firms. Black-owned firms had the highest growth rate for several measures between 1997 and 2002: 45.4 percent of the number of firms, 24.5 percent of total receipts for the group, and 16.7 percent of employer firm receipts. Asians also experienced growth in the number of employer firms, 12.6 percent, and in annual payroll, 25.3 percent. American Indian and Native Alaskan owners saw slower business growth and declines in some measures. Their business number grew 2.1 percent. Hispanics or Latinos constituted the largest minority business community and owned 6.6 percent of all U.S. firms, 3.7 percent of employer firms, and 7.4 percent of nonemployer firms.

Veterans in Business

The new *Characteristics of Veteran-Owned Businesses* (CVOB) and *Characteristics of Veteran Business Owners* (CVBO) are the Census Bureau's most important new data on veterans and service-disabled veterans in business since an earlier report based on 1992 data. The scope of the new reports is also much broader, representing the most detailed information on veterans in business ever released by Census. The data show that veteran business owner respondents to the Census surveys are overwhelmingly male, non-Hispanic, and White. They tend to be older than all business owners and are about as likely as all owner respondents to have bachelor or postgraduate degrees. More than half of employer veteran respondents reported working an average of 41 hours or more per week. The business was the primary source of personal income for 50.9 percent of all owners, 47.5 percent of all veteran owners, and 44.1 percent of all service-disabled veteran owners of the respondent firms. The firms of veteran respondents are older than U.S. firms overall, on average, and are similar in receipts and employment size. More than half of the businesses described by veteran respondents operate from the owner's home. Almost 16 percent of veteran-owned respondent firms are reported to be family-owned and another 75.2 percent of veteran respondents reported their firms as having only one owner.

Social Entrepreneurship

Social entrepreneurship—the practice of responding to market failures with transformative, financially sustainable innovations aimed at solving social problems—has emerged at the nexus of the public, private, and nonprofit sectors. This "new breed" of entrepreneurship, in the words of author Andrew Wolk of Root Cause in Massachusetts, "exhibits characteristics of nonprofits, government, and business—including applying traditional, private-sector entrepreneurship's focus on innovation, risk-taking, and large-scale transformation to social problem solving." The author details a number of examples of social entrepreneurship efforts, the market failures they address, the innovative approaches they employ, their prospects for financial sustainability, and the ways society benefits. He then details a number of ways various levels of government currently support these kinds of efforts—by encouraging social innovation, creating an enabling environment, rewarding performance, scaling success, and producing knowledge.

Pre-venture Planning

In any given year, about 7 percent of the working age population in the United States is actively engaged in efforts to start a business. Within about two years, some of these entrepreneurial efforts will result in the creation of new businesses. Given the millions of people and billions of dollars involved in new business startups, important benefits are to be had from insights into ways that entrepreneurs could improve their chances of business success, as well as minimize their losses from investing in nonviable opportunities. Professors William B. Gartner and Jainwen (Jon) Liao provide compelling evidence that engaging in business planning can significantly improve an entrepreneur's chances of successfully starting a business. They base their research on a unique survey of people in the process of starting businesses in the United States, the Panel Study of Entrepreneurial Dynamics. They compare entrepreneurs who ended up starting a business with those who were still in the process of starting one, and those who quit the process. Those who engaged in business planning during the startup phase and wrote a formal business plan were more likely to be in the group that successfully started a business. Planning matters!

The Regulatory Flexibility Act in Fiscal Year 2006

Enacted in 1980, the Regulatory Flexibility Act (RFA) requires federal agencies to determine the impact of their rules on small entities, consider alternatives that minimize small entity impacts, and make their analyses available for public comment. President Bush's Executive Order 13272, signed in August 2002, gave agencies new incentives to improve their compliance with the RFA. The SBA's Office of Advocacy oversees implementation of the law. Advocacy efforts helped result in FY 2006 savings to small entities of $7.25 billion in first-year and $117 million in annually recurring regulatory costs. These figures are just one important measure of the effectiveness of the law's implementation, but they do not capture the totality of Advocacy's efforts. Often, confidential preproposal communications are where the greatest benefits are achieved in agency compliance with the RFA and in the choice of alternatives that reduce a rule's impact on small firms. To further enhance implementation of E.O. 13272, the Office of Advocacy introduced online RFA training for federal agencies in 2006.

In response to Advocacy's model state legislation initiative, 19 states had enacted legislation as of 2005, and 11 more introduced regulatory flexibility legislation in 2006. Two states enacted it, and two more governors signed executive orders. As of summer 2007, 37 state legislatures had considered regulatory flexibility legislation and 22 had implemented it by law or executive order. The importance of state regulatory flexibility for small businesses is demonstrated in a real-life example from Arkansas, where new elevator retrofit requirements would have imposed significant financial burdens on small businesses. As a result of the agency's careful consideration of the rule pursuant to the state regulatory flexibility law, owners of certain types of elevators were given more time to come into compliance and exemptions were allowed in certain cases where the regulation would have caused undue hardship and where reasonable safety could be assured.

1 *The* Small Business Economy

Synopsis

In 2006, the economic expansion that began early in the decade continued, with small businesses, which represent about half of the private sector, at the core. Output rose, business income and profits were up, and unemployment was down. The estimated number of firms and self-employed individuals continued to climb. The decline in output in the first quarter led to concerns about the future direction of the economy, particularly with the weakening housing market affecting the balance sheets of consumers.

Introduction

Defining small businesses and their contributions is a daunting task that requires capturing a moving target. Businesses start small and if things go well, they grow into large firms. Small firms are sometimes bought by large firms, resulting in added complexity in data collection. Fortunately, in one year's time, few businesses merge or change size classes, so the information presented here should be an accurate guide to the status of small business.

For research purposes, the Office of Advocacy often defines a small business as one with fewer than 500 employees.[1] By this definition, about half of the private sector employment and output is attributable to small businesses. In 2004, the most recent year for which firm size data are available, small businesses with fewer than 500 employees accounted for all of the net new jobs. Small firms had a net gain of 1.86 million new jobs, while large firms with 500 or more employees had a new loss of 181,000 jobs.

Small firms employed 50.9 percent of the private sector work force and generated 50.7 percent of the nonfarm private gross domestic product.[2] This

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1 For government program purposes, the U.S. Small Business Administration's Office of Size Standards, www.sba.gov/services/contractingopportunities/sizestandardstopics/, lists criteria for small business size designation by industry.

2 U.S. Census Bureau data and the U.S. Small Business Administration, Office of Advocacy contract, *The Small Business Share of GDP, 1998-2004,* submitted by Kathryn Kobe, Economic Consulting Services, LLC, April 2007.

500-employee threshold also means about 99.9 percent of employer businesses are small, and of course all nonemployer businesses are small. The size difference between the average small and large business was stark in 2004, according to the latest U.S. Census Bureau data. The mean small employer had one location and 10 employees, while the mean large employer had 62 locations and 3,313 employees. The median employer size was about 4 employees for small firms and 1,000 employees for large firms.

Although advocates for small and large businesses may sometimes view the world in small vs. large (or David vs. Goliath) terms, the more likely scenario is the David and Goliath partnership that William Baumol presents.[3] That is, most of the private expenditure for research and development comes from large firms, but a critical share of innovative breakthroughs are made by modest-sized firms. These breakthroughs are most often in turn developed by large companies, which add "capacity, reliability, user-friendliness and marketability more generally."[4]

Although small and large businesses may be more partners than competitors, economic conditions can affect them in different ways. General macroeconomic variables may not accurately portray the status of small businesses. Along with macroeconomic variables, indicators such as the number of businesses, business turnover, and availability of financing are evaluated as indicators of the health of small business.

Sections following this introduction include a brief evaluation of the small business environment in 2006, the demographics of small business owners, a focus on business costs, and a glance at the future. Additional numerical and historical data in Appendix A provide a further look at the small business marketplace.

Small Business in 2006

The softening of the housing sector in 2006 seemed reasonably contained in the resilience of the overall economy. Output was up, with real GDP rising 3.3 percent in 2006, inflation (as measured by the GDP deflator) declined throughout the year, and unemployment dropped to end at an historic low of 4.5 percent (Table 1.1).

3 See U.S. Small Business Administration, Office of Advocacy, *The Small Business Economy: A Report to the President, 2005* (Washington, D.C.: National Technical Information Service: 2006), 183.

4 Ibid.

Table 1.1 Quarterly Economic Measures, 2005-2006 (percent)

	2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Real GDP change (annual rates)	3.4	3.3	4.2	1.8	5.6	2.6	2.0	2.5
Unemployment rate	5.3	5.1	5.0	5.0	4.7	4.7	4.7	4.5
GDP price deflator (annual rates)	3.4	2.5	3.3	3.3	3.3	3.3	1.9	1.7
Productivity change (annual rates)	3.4	0.5	4.3	-0.2	3.8	1.0	-0.3	1.0
Establishment births	-9.0	7.5	1.1	0.0	-5.9	2.0	-5.3	11.7
Establishment closures	8.4	-2.0	-0.3	-2.9	3.6	0.0	2.3	-1.1

Source: U.S. Small Business Administration, Office of Advocacy, from figures provided in Economic Indicators by the U.S. Department of Commerce, Bureau of Economic Analysis, and the U.S. Department of Labor, Bureau of Labor Statistics.

Indicators more related to small businesses were also positive. The numbers of both unincorporated and incorporated self-employed workers were up from 2005, reaching 10.6 million and 5.5 million, respectively, in 2006 (Table 1.2).[5] The estimated number of employer firms was also up to an estimated 6 million, as employer births outpaced terminations. Business bankruptcies declined significantly from the previous year, most likely because of a change in the bankruptcy laws.

Other statistics showed that small business finances on the whole were solid. While the prime rate rose 28.6 percent in 2006, commercial and industrial loan dollar amounts rose 14.7 percent. Banks had been loosening standards for small business loans throughout the year; however, as concerns about the future developed, demand for small business loans began to decline.

The increase in small business lending matched an increase in sales and income. Sales were above inflation in manufacturing and trade industries. Nonfarm proprietorship income rose 5.5 percent during the year and corporate profits rose 21.4 percent.

Corporate growth was also seen in the equity markets. Although few small businesses will grow to become publicly traded firms, the markets are important to the small business community nonetheless, as many aspiring owners invest their savings for later use as seed capital. The financial markets were positive in 2006. The S&P rose 8.6 percent and the NASDAQ rose 7.8 percent. Even with the solid gains, both markets were below their 2000 levels.

5 The self-employed here reflect those who claim self-employment as a primary occupation

Table 1.2 Business Measures, 2005-2006			
	2005	2006	Percent change
Employer firms (nonfarm)	5,995,200 e.	6,080,000 e.	1.4
Employer firm births	653,100 e.	649,700 e.	-0.5
Employer firm terminations	543,700 e.	564,900 e.	3.9
Self-employment, nonincorporated	10,500,000	10,600,000	1.0
Self-employment, incorporated	5,300,000	5,500,000	3.8
Business bankruptcies	39,201	19,695	-49.8

e=estimate

Sources: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Department of Commerce, Bureau of the Census; the U.S. Department of Labor; and Administrative Office of the U.S. Courts.

Small businesses continued to drive employment in the first three months of the year, as firms with fewer than 500 employees accounted for most of the net job increase. The overall nonfarm private sector employment increase of 2.3 percent was low relative to other periods, but occurred in the context of a tightening labor market as unemployment declined to 4.6 percent in 2006 from 5.1 percent in 2005. However, a tightening labor market often is seen as indicating an increase in productivity, which has been at a decade low. The rise in wages was contained at 3.2 percent. Wages are a small business cost, discussed in more detail below.

Demographics

Small business owners are a diverse group composed of individuals of all ages, races, and genders, empowered by running their own businesses.[6]

In 2005, 10 percent of American workers chose self-employment (including incorporated self-employment) as their primary occupation (Tables 1.3 and A.13). Self-employment rates were highest among the disabled, older age categories, veterans, and individuals with more formal education. Self-employment rates were below the national average for women and for Black and Hispanic individuals.

6 Owner characteristics information is available through the Bureau of the Census's Economic Census Survey of Business Owners (SBO) and the joint Census/Bureau of Labor Statistics (BLS) Current Population Survey (CPS). Recently the SBO released very detailed 2002 figures by owner type, industry, and location (www.census.gov/csd/sbo/.) While this program produces invaluable geographic and industry figures, this section will employ the CPS figures in an attempt to focus on more current information.

Black and Hispanic self-employed individuals had much larger percentage increases than the self-employed as a whole over the last decade. Self-employment in the United States increased 13.1 percent from 1995 to 2005, and it increased 26.6 and 95.7 percent, respectively, for Black and Hispanic individuals. Also besting the national figures, the number of self-employed Asians and American Indians increased 60.6 percent during this time frame. Much of the national increase was among immigrants, as the native-born self-employed population increased 7.4 percent over the decade.

Education continues to be the gateway toward success. Self-employment declines were seen in high school graduates, while self-employed college graduates and individuals with masters degrees and above increased 35 percent and 29 percent, respectively.

Mirroring labor force trends, the number of self-employed in the 55 to 64 age category increased 46.6 percent for the period. Surprisingly, the number of self-employed individuals aged 25 to 44 declined. Also mirroring labor force trends was the 22.3 percent decline in the number of veteran self-employed individuals, as older veterans retire.[7] Veterans increased their self-employment rates in recent years, most likely the result of the aging of the veteran population, as older individuals are more likely to choose self-employment. Advocacy-funded research shows that service-disabled veterans had lower self-employment rates than veterans who were not service-disabled. This gap grew during the late 1990s.[8]

By location, while rural areas had a higher than average rate of self-employment, 12.4 percent, the rate declined 13.5 percent from 1995 to 2005. Urban areas were at the opposite end of the spectrum. They had a below-average self-employment rate of 9.2 percent and a 42 percent increase over the decade. The suburbs, with the highest rates of self-employment, mirrored national trends.

7 Unfortunately, the number of military reservists that are self-employed is not available from the data source.

8 The report also found that increased computer ownership could slightly increase self-employment among both service disabled and non-disabled veterans. See *Self-Employment in the Veteran and Service-Disabled Veteran Population*, Open Blue Solutions, funded by the Office of Advocacy, http://www.sba.gov/advo/research/rs291tot.pdf.

Table 1.3 Self-Employment Demographics, 1995–2005

	Self-employment rate, 2005	Percent change 1995 - 2005
Total	10.1	13.1
Female	7.2	13.3
Male	12.7	12.9
Asian / American Indian	10.6	60.6
Black	4.5	26.6
White	10.9	8.7
Multiple race	9.3	NA
Hispanic origin	6.7	95.7
Veteran status	15.1	-22.3

NA= Not available.

See Table A.13 for notes and source.

Small Business Costs

As a group, small business purchasers outpace federal government purchasing. Small businesses are a heterogeneous group, reflecting all industries and a wide range of employment and receipts sizes (employers, nonemployers, home-based, etc.) and ages. Aggregating costs across different firm types can be difficult. In fact, aggregating across industries can be misleading, but it is hoped that this section informs the reader of available small business cost data. Fortunately, many of the federal data are available in detail by industry.

The U.S. Census Bureau Business Expenses Survey is one source of data for small business costs; it covers only a few industries (trades), and is available only for years ending in 2 and 7, and generally does not include data by firm size. Some manufacturing and construction cost data are available by firm size in the Census Bureau's Economic Census, but these Census data are not available for most industries.

The most complete source of small business cost data is the Internal Revenue Service's Statistics of Income, which uses tax deductions as a proxy for costs. Table 1.4 shows business tax return deductions by the receipts size of the business.[9] The U.S. economy is becoming more service-based, but goods-producing industries still carry a large share of business costs: the cost

9 Note that a business tax return does not necessarily represent a business, as a business can file more than one tax return.

Table 1.4 Business Deductions, 2002

	Total	Receipts size of business: <$100,000	$100,000 - $1 million	$1 - 10 million	$10 - 50 million	$50 million or more
Number of tax returns	26,434,293	20,521,285	4,698,590	1,062,630	123,607	28,183
Deductions (billions of dollars)						
Costs of goods sold	12,389.4	54.6	486.5	1,495.5	1,606.8	8,746.0
Salaries and wages	2,322.6	29.4	206.8	384.9	273.5	1,428.1
Interest paid	992.3	12.8	22.4	43.8	56.3	857.0
Depreciation	831.1	28.5	48.9	69.8	61.7	622.2
Taxes paid	447.9	8.8	41.4	71.6	46.5	279.5

Note: Nonfarm businesses include tax returns with and without net income. More specific size categories and data by major industry and legal form of organization are available from the data provider.

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income.

of goods sold outpaced the cost of wages and salaries for all of the receipts size classes presented.[10] The next largest cost categories are interest and depreciation. Comparing costs associated with labor to those associated with capital indicates that labor costs are relatively more important for businesses in the middle receipts size classes than for the smallest and largest firms.[11]

Depreciation costs result from investments in capital expenditures. Capital expenditures are not broken out by business size other than a general proxy for size, and for employer and nonemployer firms. But even nonemployer businesses had large capital expenditures. They spent $32.9 billion on structures and $49.4 billion on equipment in 2005, about one-third of which was previously used equipment. Nonemployers accounted for 7 percent of all company capital expenditures.[12]

The IRS aggregate figures give the impression that the costs of goods sold are higher than labor costs for *most* small businesses; however, the high

10 The "cost of goods sold" is an income statement figure that reflects the cost of obtaining raw materials and producing finished goods that are sold to consumers. Technically, the cost of goods sold equals the beginning merchandise inventory, plus net purchases of merchandise, minus the ending merchandise inventory.

11 With owners often receiving salary in the form of profits in the smaller size classes, one could argue that capital replaces labor as firms grow in size.

12 See U.S. Census Bureau, *Annual Capital Expenditures, 2005* (www.census.gov/csd/ace/xls/2005/ace-05.pdf).

cost of goods sold may simply reflect that a minority of small businesses had very high costs, skewing the total. The National Federation of Independent Business (NFIB) conducted a 2006 survey showing salaries, wages, and commissions as the largest expense for most small businesses.[13]

One of the larger small business costs, and the cost for which the most information is available by firm size, is payroll. In 2004 (the latest year for which data are available), firms with fewer than 500 employees had $1.9 trillion in annual payroll, not including benefits. This small business share, at 45.1 percent of the total (nonfarm) private sector payroll of $4.3 trillion, was down from 47.9 percent 15 years previously. The decline in the small business share of payroll echoes the 2.9 percent decline in the small business share of employment. Most of the payroll was in the larger small firms with 20 to 499 employees, which represent two-thirds of the small business total. Nonemployers generally do not have payroll; receipts are a similar indicator for these largely service-oriented businesses. Nonemployers had $887 billion in receipts in 2004.

Other unique labor costs are contract labor and commissions; these data are available from IRS by legal form of organization—proprietorship, partnership, or corporation—rather than receipts size. While a large share of small businesses are proprietorships, a large share of their economic activity is in corporations. Automobile expenses constituted 7 percent of deductions for sole proprietors; advertising and travel were both 1 percent (Table 1.5). Purchases alone constituted 27 percent.

With purchases making up a relatively large share of small business costs, it is not surprising that small businesses tend to sell to other businesses. The U.S. Census Bureau's 2002 Survey of Business Owners shows that 41 percent of employer firms had 10 percent or more of their sales to other businesses. For nonemployers the share was 33 percent.[14] Manufacturing, wholesale trade, information, and professional/scientific/technical services industries had high levels of sales to other businesses.

These publicly available data may not be detailed enough for data users. To bridge this gap, private sources of financial statement amounts and ratios by industry are available for purchase, and some trade associations have surveyed their members about their costs.

13 *Expenses*, NFIB National Small Business Poll, Volume 6, Issue 4, 2006 (www.nfib.com/object/sbPolls).

14 Both figures were adjusted for nonresponse.

Table 1.5 Nonfarm Sole Proprietors' Deductions, 2004

	Number of sole proprietor returns
Total	20,590,691
	Business deductions (billions of dollars)
Total (billions of dollars)	892.4
Cost of sales and operations, total	371.0
Inventory, beginning of year	35.8
Cost of labor	31.8
Purchases	238.9
Materials and supplies	53.3
Other costs	50.2
Inventory, end of year	39.0
Advertising expenses	12.9
Car and truck expenses	59.0
Commissions	13.3
Contract labor	24.7
Depletion	0.8
Depreciation	42.9
Employee benefit programs	2.6
Insurance	18.9
Legal and professional services	9.0
Meals and entertainment deducted	6.0
Mortgage interest	5.2
Other interest paid on business indebtedness	5.9
Office expenses	12.4
Pension and profit-sharing plans	1.2
Rent on machinery and equipment	8.7
Rent on other business property	28.1
Repairs	14.8
Supplies	27.3
Salaries and wages	71.1
Taxes paid	16.0
Travel	10.3
Utilities	21.5
Other business deductions	98.3
Home office business deductions	7.8

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Department of the Treasury, Internal Revenue Service, Statistics of Income.

Continued Growth?

The previous section discussed the economic climate in 2006 or the most recent years for which data are available by size of firm or other criteria. To keep readers up to date with small business information beyond 2006, the Office of Advocacy summarizes current small business statistics in *Small Business Quarterly Indicators*.[15] Early 2007 indicators portray a slight slowing of the economy. Real GDP dropped to an annual increase of 1.3 percent in the first quarter and the increase in private sector jobs was slowing. The unemployment rate declined throughout the first quarter. A review of initial small business opinion about 2007 from the NFIB indicates a declining trend in the percentage of owners who thought the following three-month period was a good time to expand.[16] The surveys found small business optimism declining for the first four months of 2007. In addition, taxes surpassed insurance (health care) as small businesses' top concern in 2007.[17] In early 2007, among the issues appearing on the small business radar screen were housing market concerns as well as concerns about increasing energy costs. These may have contributed to the decline in small business loan demand for the first two quarters, as reported by the Federal Reserve Board's Senior Loan Officer Survey.

15 See the appendix to this chapter and www.sba.gov/advo/research/sbei.html for more detail.

16 NFIB monthly survey.

17 National Federation of Independent Business, *Small Business Economic Trends, see www.nfib.com/page/sbet*. The federal government recognizes these concerns, as shown in the opening letter to Congress in the *Economic Report of the President, 2007* (United States, Government Printing Office, Washington, DC, 2007); "… we must work to make private health insurance more affordable and to give patients more choices and control over their health care." and "Sound economic policy begins with low taxes." See also chapters focusing on each concern.

Appendix: Staying Current with Small Business Data

As noted, *The Small Business Economy* series (like its predecessor, *The State of Small Business*) discusses the economic trends of the previous year, in this case 2006. This allows the economists in the Office of Advocacy to provide a clear and comprehensive examination of the events of the past year, while providing as many data points as possible. Indeed, cumulatively, the books in this series provide a longitudinal examination of the small business economic climate from 1982 to the present.

Many readers, however, may want to know about *current* economic trends. Since 2004, the Office of Advocacy has also prepared the *Quarterly Indicators: The Economy & Small Business* as a supplement to this annual publication. It is released about five weeks after the end of a quarter, and can provide useful information for individuals seeking information about current economic trends relevant to small businesses.[18]

A major challenge for economists seeking to discuss small business trends is the limited amount of current data by firm size. Much of the analysis of economic data in the *Quarterly Indicators* stems from general macroeconomic statistics simply because of the scarcity of small-business-specific information. Given that small businesses constitute such a large portion of the overall economy, though, it is reasonable to assume that trends in the macroeconomy will mirror those of the small business community.[19]

Each issue of the *Quarterly Indicators* includes trends in real gross domestic product (GDP), business confidence, employment, and inflationary pressures. For the noneconomist, it is important to understand that real GDP is the most comprehensive measure of overall output that economists look at to gauge the U.S. economy's performance. Its components include consumption, government spending, private investment, and net exports (Table 1A.1). A thorough understanding of these components provides clues about the current strengths and weaknesses inherent in the economy. For instance, overall pessimism or concern about the future economic situation might lead to reduced consump-

18 All issues of the Quarterly Indicators: The Economy & Small Business, from the first quarter of 2004 to present, are available online at http://www.sba.gov/advo/research/sbei.html.

19 According to an April 2007 study by Kathryn Kobe of Economic Consulting Services for the Office of Advocacy, small businesses produced half of private, nonfarm gross domestic product. For more information, see http://www.sba.gov/advo/research/rs299tot.pdf.

Table 1A.1 Real Gross Domestic Product and Components, 2001–2006

	Annual data						Quarterly data for 2006			
	2001	2002	2003	2004	2005	2006	Q1	Q2	Q3	Q4
Real gross domestic product *										
Level (trillions of dollars)	9.89	10.05	10.30	10.70	11.05	11.42	11.32	11.39	11.44	11.51
Annual change (percent)	0.8	1.6	2.5	3.9	3.2	3.3	5.6	2.6	2.0	2.5
Real personal consumption expenditures *										
Level (trillions of dollars)	6.91	7.10	7.30	7.58	7.84	8.09	8.00	8.06	8.11	8.20
Annual change (percent)	2.5	2.7	2.8	3.9	3.5	3.2	4.8	2.6	2.8	4.2
Real government consumption and gross investment *										
Level (trillions of dollars)	1.78	1.86	1.90	1.94	1.96	2.00	1.99	1.99	2.00	2.02
Annual change (percent)	3.4	4.4	2.5	1.9	0.9	2.1	4.9	0.8	1.7	3.4
Real gross private fixed investment *										
Level (trillions of dollars)	1.60	1.56	1.61	1.77	1.87	1.95	1.96	1.97	1.96	1.89
Annual change (percent)	-7.9	-2.6	3.6	9.8	5.4	4.3	7.8	1.0	-0.7	-15.2
Real exports of goods and services *										
Level (trillions of dollars)	1.04	1.01	1.03	1.12	1.20	1.30	1.27	1.29	1.31	1.34
Annual change (percent)	-5.4	-2.2	1.3	9.2	6.8	8.9	14.0	6.2	6.8	10.6
Real imports of goods and services *										
Level (trillions of dollars)	1.44	1.48	1.55	1.71	1.82	1.92	1.91	1.91	1.94	1.93
Annual change (percent)	-2.7	3.4	4.1	10.8	6.1	5.8	9.1	1.4	5.6	-2.6

Notes: Seasonally adjusted; * Chained 2000 dollars.

Source: U.S. Small Business Administration, Office of Advocacy, using data from the U.S. Department of Commerce, Bureau of Economic Analysis.

tion spending or investment on the part of businesses (and vice versa), or a slump in new housing construction could dampen the nation's output (as it did in 2006) through dramatic decreases in real gross private fixed investment.

Expectations can play a large role in shaping the future growth of the economy. Office of Advocacy research shows that small business output is rising when the NFIB's optimism index exceeds 100.[20] Moreover, the public's

20 See a July 2003 Office of Advocacy study by Joel Popkin and Company titled, "Small Business during the Business Cycle," which can be found at: http://www.sba.gov/advo/research/rs231tot.pdf.

mood can influence their willingness to open their wallets. Real personal consumption accounts for around 70 percent of real GDP; thus, spending habits can have a large impact on output. In addition, such mood swings can also determine whether a small business expands or hires new workers.

One of the most followed statistics is the U.S. unemployment rate. Indeed, even many noneconomists casually follow the unemployment rate, which was between 4.4 and 4.8 percent in 2006. The economy generated nearly 2.3 million net new nonfarm payroll jobs in 2006. Yet it is also important to "drill down" into these statistics to ascertain where the new jobs are coming from. It should not surprise many that almost all of the net new jobs have been in the service sector in recent years. Table 1A.2 shows the breakdown of nonfarm payroll employment by major industry sector for 2006. The vast majority of the new jobs in 2006 were in wholesale trade, financial activities, professional and business services, educational and health services, leisure and hospitality, and government. In all but the government sector, at least 40 percent of firms are small. The manufacturing sector, in contrast, lost 90,000 jobs during the course of the year—continuing a trend of reduced employment as a result of increased productivity and greater global competition.

The fourth element of importance in the *Quarterly Indicators* is inflation. For many years, inflation has not been a household concern for many Americans, but with rising energy prices in the past couple of years, consumers and business owners have once again felt the impact on their pocketbooks of higher prices. This can be felt in two ways. First, the Federal Reserve combats inflationary pressures in the economy by raising interest rates—a response that increases the overall cost of borrowing for both individuals and businesses. Second, to the extent that higher prices constitute a greater proportion of one's overall budget, they can also affect the psyche. Measures of confidence, including the NFIB optimism index and the University of Michigan's consumer confidence survey, have tended to be highly correlated lately with the price of oil. If the cost of filling up the gas tank is higher, the public tends to be more pessimistic in these surveys, and vice versa.

Possible New Sources of Small Business Data

For those seeking current data on small business, several possible new sources with shorter lags than many current sources will provide some clues. The U.S. Department of Labor's Bureau of Labor Statistics (BLS), for instance,

Table 1A.2: Monthly Employment on Nonfarm Payrolls by Major Sector, 2006 (millions)

	Percent small business	2006 monthly data												2006 average
		Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	
Nonfarm payrolls	50.92	135.11	135.41	135.66	135.80	135.91	136.03	136.25	136.44	136.64	136.75	136.94	137.17	136.18
Goods-producing industries	57.61	22.49	22.54	22.57	22.60	22.59	22.61	22.62	22.63	22.63	22.57	22.53	22.52	22.58
Natural resources and mining	51.24	0.66	0.66	0.67	0.68	0.68	0.68	0.69	0.69	0.69	0.70	0.70	0.71	0.68
Construction	86.43	7.62	7.67	7.69	7.70	7.70	7.69	7.70	7.72	7.73	7.71	7.68	7.68	7.69
Manufacturing	44.00	14.22	14.21	14.21	14.23	14.22	14.24	14.23	14.22	14.21	14.17	14.14	14.13	14.20
Service-producing industries	49.36	112.62	112.87	113.09	113.20	113.31	113.42	113.63	113.81	114.01	114.17	114.42	114.65	113.60
Trade, transportation, and utilities	45.35	26.16	26.19	26.23	26.21	26.19	26.20	26.23	26.23	26.24	26.26	26.32	26.35	26.23
Wholesale trade	61.58	5.84	5.85	5.87	5.88	5.89	5.89	5.90	5.91	5.92	5.92	5.93	5.96	5.90
Retail trade	42.16	15.35	15.35	15.38	15.34	15.30	15.30	15.31	15.30	15.29	15.30	15.33	15.32	15.32
Information	26.17	3.05	3.06	3.06	3.06	3.05	3.05	3.04	3.05	3.05	3.05	3.06	3.07	3.05
Financial activities	41.43	8.27	8.30	8.31	8.34	8.35	8.35	8.37	8.38	8.41	8.42	8.42	8.44	8.36
Professional and business services	44.95	17.32	17.39	17.43	17.46	17.50	17.54	17.59	17.62	17.64	17.66	17.73	17.79	17.56
Education and health services	48.08	17.62	17.67	17.71	17.74	17.78	17.79	17.83	17.89	17.95	17.98	18.02	18.06	17.84
Leisure and hospitality	62.09	12.95	12.98	13.02	13.05	13.07	13.09	13.16	13.19	13.21	13.26	13.32	13.37	13.14
Other services	86.27	5.42	5.42	5.42	5.42	5.43	5.43	5.43	5.43	5.44	5.45	5.44	5.45	5.43
Government	0	21.84	21.88	21.91	21.92	21.94	21.97	21.99	22.02	22.08	22.10	22.11	22.11	21.99

Notes: Seasonally adjusted. See http://www.bls.gov/ces/cessuper.htm for NAICS code equivalents for each sector. The small business percentages by sector are based on 2004 firm size data. See http://www.sba.gov/advo/research/us04_n6.pdf.

Sources: U.S. Small Business Administration, Office of Advocacy, using data from the U.S. Department of Commerce, Bureau of the Census, and U.S. Department of Labor, Bureau of Labor Statistics.

has been preparing the Business Employment Dynamics (BED) data series, which shows net employment changes by firm size and industry with a three-quarter lag.[21] In addition, the Ewing Marion Kauffman Foundation has been funding a new data series, the Kauffman Index of Entrepreneurial Activity, which is produced by Robert Fairlie of the University of California at Santa Cruz. This index shows the rate of new entrepreneurial activity in a given year by state, industry, and a variety of demographic statistics.[22] While neither of these datasets is current enough to appear in the *Quarterly Indicators,* both do provide a recent snapshot of the economic dynamism in the economy.

The BED data series is an example of what can be accomplished through the use of administrative data. It is generated from the Quarterly Census of Employment and Wages (QCEW, or ES-202) program coordinated jointly between BLS and the states. In essence, the data are gathered through the unemployment insurance programs at the state level. The use of administrative data provides a wealth of more timely information and reduces the burden of having individuals or business owners complete additional surveys.

The National Research Council of the National Academies recently completed a two-year analysis of federal data sources, *Understanding Business Dynamics: An Integrated Data System for America's Future.*[23] One of its recommendations was to increase the use of administrative data. Other recommendations include increased data sharing among federal agencies to reconcile and enhance data series, and increased emphasis in the data collection process on nascent and new enterprises. It is too early to see how many of the recommendations from this examination come to fruition. At a minimum, though, the dialogue between the data collection agencies and the study members has, it is hoped, led to an increased awareness about the need for more data on businesses, especially by firm size. With a little luck, some of these conversations will lead to new data series in the future that will be relevant to the analysis of the state of small businesses in the United States.

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21 See http://www.bls.gov/bdm/home.htm.

22 See http://www.kauffman.org/items.cfm?itemID=703.

23 To peruse or purchase this book online, see http://books.nap.edu/openbook.php?record_id=11844&page=R1.

2 Small Business Financing *in* 2006

Synopsis

As the economy continued to grow at a slower, but still healthy pace in 2006, total business borrowing increased by one-third, from $562 billion in 2005 to $753 billion in 2006, an historic high. The level of increase in borrowing by nonfarm, noncorporate businesses declined slightly, from $304 billion to $289 billion over the period. Nevertheless, small business credit continued to expand in 2006 because of favorable economic conditions and a financial market with ample liquidity. Demand for loan types other than corporate loans for mergers and acquisitions weakened slightly by the end of the year as lenders tightened lending criteria. Although financing was available to small firms, borrowing costs continued to rise in 2006.

Data from the National Survey of Small Business Finances indicate that most small businesses used traditional credit such as credit lines, loans, or capital leases and that most of the increases were in credit lines and credit cards.

Bank consolidations continued over the 2005-2006 period. The number of multibillion-dollar lending institutions increased from 101 in June 2005 to 108 in June 2006, and accounted for 75.2 percent of total domestic assets, 64 percent of total business loans, and 45 percent of small business loans. The largest lenders continued to increase their dominance in loans under $100,000, especially credit cards.

Equity markets increased at a moderate pace, and the average offering size in the initial public offering (IPO) market increased, while the number of IPOs dipped slightly.

Economic and Credit Conditions in 2006

In spite of four interest rate increases, the U.S. economy continued to grow at a healthy pace in 2006, although more slowly than in the previous two years. Although the housing market cooled considerably during this period, consumer spending remained strong. Rising employment and accumulated household wealth from a long period of appreciation in the housing market were complemented by robust business investments in a very accommodating financial market. Core inflation was slightly higher in 2006 than in 2005. The 2006 rate moved up slightly over the previous year, but it continued to respond to the increase in interest rates. Generally, financial market conditions were conducive to economic expansion. As a result, real gross domestic product grew 3.4 percent, up from 3.1 percent the previous year.

Interest Rate Movements

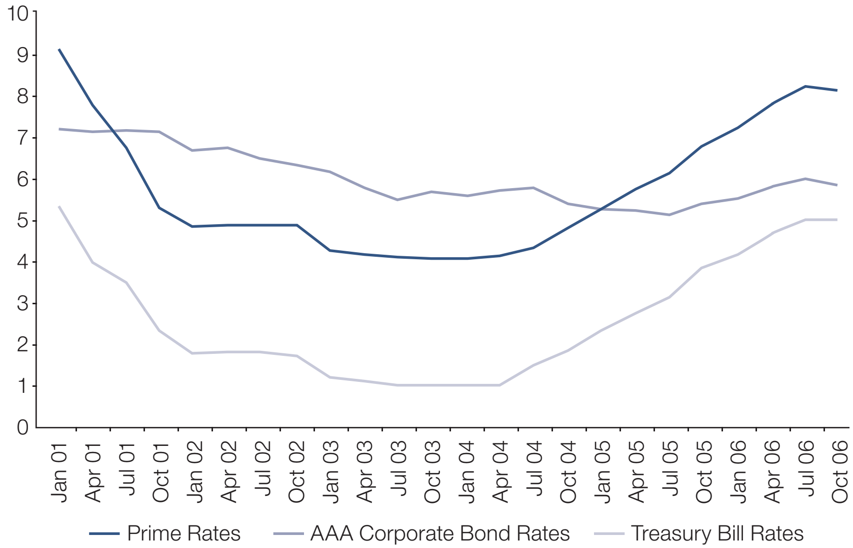
Short-term interest rates continued to rise and remained high at the end of 2006. The Federal Reserve maintained a policy of high interest rates as the economy entered its fourth year of recovery and expansion. The federal funds rates went from 4.25 percent in January to 5.25 percent by the end of December. Long-term interest rates rose slightly during the first half of the year but ended the year unchanged. (These movements are determined by the demand and supply in the capital markets.) Rates for AAA corporate bonds reached a high of 5.95 percent in May 2006 and declined steadily for the rest of the year (Figure 2.1).

Interest rates on small loans followed a pattern similar to interest rate movements in the financial markets. Rates paid by small business owners increased consistently, corresponding to rising prime rates, which moved from 7.25 percent at the beginning of the year and leveled off at 8.25 percent in July (Figure 2.1). Fixed-rate loans with a term of one year or more rose to 8.97 percent in August, the highest rate since August 2001, when they reached 8.73 percent. They declined slightly by the end of the year. Variable-rate loans with terms of 2 to 30 days for the smallest loans increased from 6.69 percent in November 2005 to 7.92 percent in November 2006. Variable-rate loans with terms of 31 to 365 days also increased in 2006 (Figure 2.2 and Table 2.1).

The Nonfinancial Sector's Use of Funds in Capital Markets

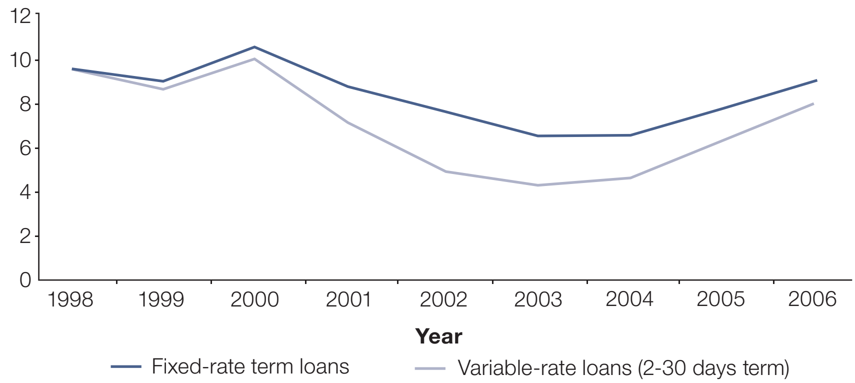
In general, domestic borrowing in the credit markets slowed modestly from the record pace of borrowing in 2005. Declines in net borrowing by the federal government and the household sector were offset by large increases in corporate borrowing. Total net borrowing by the nonfinancial sectors in the

Figure 2.1 Interest Rate Movements, 2001 - 2006



Source: Board of Governors of the Federal Reserve System, *Federal Reserve Bulletin*, various issues.

Figure 2.2 Bank Loan Rates for Loans under $1 Million, August 1998-2006



Source: Board of Governors of the Federal Reserve System, *Survey of Terms of Lending*, Statistical Release E.2, various issues, and special tabulations prepared by the Federal Reserve Board for the Office of Advocacy.

Table 2.1 Loan Rates Charged by Banks by Loan Size (percent), February 2005–November 2006				
	Loan size (thousands of dollars)	Fixed-rate term loans	Variable-rate loans (2-30 days term)	Variable-rate loans (31-365 days term)
November 2006	1.0-99	8.76	7.92	8.61
	100-499	8.06	7.67	8.00
	500-999	7.77	7.40	7.91
	Minimum-risk loans	6.90	5.89	6.27
August 2006	1.0-99	8.97	7.96	8.69
	100-499	8.28	7.81	7.77
	500-999	7.62	7.64	7.53
	Minimum-risk loans	7.57	5.93	6.35
May 2006	1.0-99	8.38	7.71	8.14
	100-499	8.00	7.38	7.61
	500-999	7.61	7.25	7.35
	Minimum-risk loans	5.65	4.54	5.77
February 2006	1.0-99	8.43	7.19	8.28
	100-499	7.64	7.10	7.31
	500-999	7.34	6.83	7.36
	Minimum-risk loans	6.94	5.09	6.22
November 2005	1.0-99	8.07	6.69	7.72
	100-499	7.48	6.65	7.41
	500-999	6.70	6.38	7.00
	Minimum-risk loans	4.98	4.51	4.88
August 2005	1.0-99	7.90	6.09	7.09
	100-499	6.89	6.23	6.52
	500-999	6.39	5.82	5.65
	Minimum-risk loans	4.24	4.12	4.15
May 2005	1.0-99	7.48	5.74	7.13
	100-499	6.44	5.71	6.27
	500-999	5.74	5.49	5.27
	Minimum-risk loans	3.9	3.79	3.83
February 2005	1.0-99	7.05	5.25	6.61
	100-499	6.38	5.08	6.09
	500-999	5.82	4.52	5.05
	Minimum-risk loans	6.58	3.24	4.42

Source: Board of Governors of the Federal Reserve System, *Survey of Terms of Lending*, Statistical Release E.2, various issues, and special tabulations prepared by the Federal Reserve Board for the Office of Advocacy.

U.S. economy decreased by 7.8 percent, from $2.28 trillion in 2005 to $2.10 trillion in 2006 (Table 2.2).

Federal, State, and Local Government Borrowing

Borrowing by federal, state, and local governments decreased in 2006, as a strong economy generated increased tax revenues. Federal borrowing in the financial markets declined from $307 billion to $183 billion in 2006, accounting for less than 10 percent of the total net borrowing by the nonfinancial sector (Table 2.2). The federal budget deficit declined to $248 billion from $318 billion in the previous year[1] as a result of increased federal revenues in 2006.

State and local governments' net borrowing dropped by $20 billion, from $171 billion in 2005 to $152 billion in 2006. In fact, state and local government revenues increased faster than expenditures during the first half of the year, but were outpaced by expenditures in the third and fourth quarters (Table 2.2).

Borrowing by the Household Sector

Although household borrowing slowed by 13.0 percent, from $1.2 trillion in 2005 to $1.0 trillion, it still accounted for almost half of net borrowing by the nonfinancial sector (Table 2.2). Consumer spending remained strong and was supported by gains in real income and employment growth, as well as increases in household wealth.

Business Borrowing

Confidence in the U.S. economy continued to be solid. This was evident in corporate profits, which rose from $931 billion in 2005 to $1.1 trillion in 2006—a 17 percent increase (Table 2.3). Increases in corporate borrowing helped sustain total borrowing in the financial markets at a high level. Total business borrowing increased from $562 billion in 2005 to $753 billion in 2006, an historic high. Borrowing by nonfarm, noncorporate businesses declined slightly, to $289 billion in 2006 from $304 billion in 2005 (Tables 2.2 and 2.4).

1 Based on the national income account estimates from the Federal Reserve Bank of St. Louis, "Government Revenues, Spending, and Debt," *National Economic Trends*, April 2007, 17.

Table 2.2 Credit Market Borrowing by the Nonfinancial Sector, 1996-2006 (billions of dollars)

	1993	1994	1995	1996	1997	1998	1999	2000*	2001*	2002*	2003*	2004*	2005*	2006*
Total domestic borrowing	589.4	575.2	712.0	731.4	804.7	1,041.9	1,026.6	849.6	1,137.9	1,380.7	1,684.7	1,998.7	2,278.8	2,100.3
Government														
Federal	155.9	155.9	144.4	145	23.1	-52.6	-71.2	-295.9	-5.6	257.6	396.0	396.1	306.9	183.4
State and local	74.7	-46.2	-51.5	-6.8	56.1	67.7	38.5	15.5	105.7	143.9	120.3	115.3	171.4	151.6
Business														
Farm	2.6	4.4	2.9	4.8	6.2	8.0	5.5	11.3	10.5	7.7	7.7	11.5	12.6	27.8
Nonfarm noncorporate	3.2	3.3	30.6	81.4	94.7	159.7	189.4	196.8	162.2	148.0	92.0	244.7	304.2	288.7
Nonfinancial corporate	45.5	142.3	243.7	148.8	291.1	408.4	371.6	341.8	215.2	12.9	88.6	165.2	245.0	436.9
Total	51.3	150.0	277.2	235.0	392.0	576.1	566.5	549.9	387.9	168.6	188.3	421.4	561.8	753.4
Households	205.9	316.3	350.3	358.1	332.7	450.8	492.8	580.0	649.9	810.6	980.1	1,100.1	1,238.8	1,012.0
Foreign borrowing in the United States	69.8	-13.9	71.1	88.4	71.8	31.2	13.0	63.0	-13.7	92.9	31.7	123.5	84.7	254.2

* Annual revision for statistics from 2000-2006.
Source: Board of Governors of the Federal Reserve System, Flow of Funds Accounts, First Quarter 2007: Z1, Flows and Outstandings.

Table 2.3 Major Sources and Uses of Funds by Nonfarm, Nonfinancial Corporate Businesses, 1996-2006 (billions of dollars)

	1996	1997	1998	1999	2000*	2001*	2002*	2003*	2004*	2005*	2006*
Before-tax profit	458.8	494.5	460.1	456.7	421.9	309.9	336.4	424.3	622.5	931.3	1,088.7
Domestic undistributed profit	108.3	120.2	65.1	63.2	2.5	-45.0	-12.9	-1.4	73.0	454.2	405.2
Depreciation with inventory valuation adjustment	504.2	548.2	570.6	598.1	617.7	643.8	718.7	718.4	783.4	1,020.4	963.4
Total internal funds, on book basis	612.5	659.9	635.7	660.4	631.8	632.5	720.9	732.0	823.2	1,053.0	1,008.0
Net increase in liability	398.5	283.5	616.0	987.6	1,237.4	95.2	84.9	13.4	609.0	320.3	183.3
Funds raised in credit markets	148.8	291.9	408.4	371.6	341.8	215.2	12.9	88.6	165.2	245.0	436.9
Net new equity issues	-69.5	-114.4	-215.5	-110.4	-118.2	-48.1	-41.6	-42.0	-126.6	-363.4	-602.1
Capital expenditures	684.7	760.2	826.5	866.7	928.5	802.6	737.1	749.9	822.4	881.8	1,010.5
Net financial investment	4.8	-11.1	-46.1	-17.7	-28.2	82.4	45.2	69.2	174.1	94.3	119.2

*Annual revision for statistics from 2000-2006.
Source: Board of Governors of the Federal Reserve System, Flow of Funds Accounts, First Quarter 2007: Z1, Flows and Outstandings.

Table 2.4 Major Sources and Uses of Funds by Nonfarm, Noncorporate Businesses, 1996-2006 (billions of dollars)

	1996	1997	1998	1999	2000*	2001*	2002*	2003*	2004*	2005*	2006*
Net income	569.7	609.9	656.5	710.6	767.3	820.0	817.4	836.2	922.4	979.5	1,033.5
Gross investment	110.8	118.5	125	148.7	168.7	149.2	151.5	161.4	177.3	212.4	191.8
Fixed capital expenditures	109.6	118.8	123.9	185.8	215.3	195.5	181.9	192.1	205.9	227.7	269.8
Changes in inventories	1.1	3.0	3.6	3.5	2.9	-1.6	0.7	0.7	2.4	1.0	2.2
Net financial investments	0	-3.3	-2.5	-40.6	-49.5	-44.6	-31.1	-31.4	-31.1	-16.4	-80.2
Net increase in credit	81.4	94.7	159.7	189.4	196.8	162.2	148.0	92.0	244.7	304.2	288.7
Mortgages	50.9	47.7	117.7	135.1	137.5	121.2	121.0	75.5	219.0	252.6	220.1
Net investment by proprietors	-18.1	-55.1	-64.8	-82.3	-44.9	-16.1	-85.1	27.3	-12.8	-63.3	-24.0

*Annual revision for statistics from 2000-2006.
Source: Board of Governors of the Federal Reserve System, Flow of Funds Accounts, First Quarter 2007: Z1, Flows and Outstandings.

Financing Patterns of Small Businesses

The 2003 Survey of Small Business Finances (SSBF) conducted by the Federal Reserve Board provides insight into the changing financing patterns of small businesses in the United States. Small businesses continue to use an array of internal (personal savings, business retained earnings, depreciation) and external funding sources (friends and family, other businesses, financial intermediaries, and the public markets).[2]

Overall, 60 percent of small businesses used traditional credit such as credit lines, loans, or capital leases in 2003 compared with 55 percent in 1998. Most of the increases were in the increased use of credit lines and credit cards—small firms' use of credit lines went from 28 percent in 1998 to 34 percent in 2003 (Table 2.5), and the use of business credit cards (financing) by small business owners soared from 34 percent in 1998 to almost 50 percent in 2003 (Table 2.5); the increased uses were observed for all business sizes. As will be discussed in the following section based on call report data, very large lenders have increased promotion of business credit cards to small firms over the past 10 years, as indicated by the increase in the number of business loans under $100,000 (see Table 2.11).

The SSBF showed that more small firms were using nonbank suppliers for their credit needs; for example, the share of the outstanding dollar amount for these owners was 43 percent in 2003 compared with 35 percent in 1998 (Table 2.6). However, commercial banks continue to be the main traditional source of financing for small businesses, although their share of the outstanding dollar amount decreased slightly compared with the previous survey, from 65 percent in 1998 to 57 percent in 2003.

The 2003 SSBF also showed that the use of credit lines increases with firm employment size and sales revenues. Small businesses with less than $50,000 in sales revenues were more likely in 2003 to use other traditional types of credit than firms with larger sales. Between 1998 and 2003 the use of other credit by firms with $25,000 to $50,000 in sales surged, from 7.5 percent in 1998 to 29.7 percent in 2003 (Table 2.7).

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2 The Survey of Small Business Finances (SSBF), conducted every five years since 1987, is the most comprehensive data source for the analysis of the financing behaviors of small firms in the U.S. financial markets. Currently, the Federal Reserve Board is considering eliminating this survey.

Table 2.5 Use of Selected Financial Services by Small Businesses, by Size of Firm, 1998 and 2003 (percent of firms)

	Credit line, loan, or capital lease							Nontraditional credit				
			Loan						Credit card			
Characteristic, 2003	Any	Credit line	Mortgage	Vehicle	Equipment	Capital lease	Other	Loan from owner	Personal	Business	Trade credit	Traditional and nontraditional credit
All firms												
2003	60.4	34.3	13.3	25.5	10.3	8.7	10.1	30.3	46.7	48.1	60.1	92.9
Number of employees												
0-1	42.1	19.4	5.6	17.4	4.3	4.0	7.1	25.7	48.6	32.0	35.7	83.8
2-4	53.9	27.2	12.6	22.0	5.2	6.6	7.1	27.0	48.1	45.7	55.9	93.3
5-9	72.7	43.1	15.8	30.8	13.6	11.6	13.3	33.3	47.8	56.8	71.6	96.6
10-19	77.4	50.2	19.2	35.9	21.1	12.1	16.5	31.3	45.6	59.7	80.4	97.3
20-49	82.7	57.5	21.4	36.2	26.3	16.0	15.7	36.0	34.4	61.8	85.0	99.8
50-99	87.4	68.0	18.6	36.5	27.6	22.9	16.5	32.9	34.6	63.5	88.5	98.3
100-499	93.8	82.3	28.0	35.9	32.6	27.9	18.6	28.4	32.2	71.5	85.4	98.9
	Credit line, loan, or capital lease							Nontraditional credit				
			Loan						Credit card			
Characteristic, 1998	Any	Credit line	Mortgage	Vehicle	Equipment	Capital lease	Other	Loan from owner	Personal	Business	Trade credit	Traditional and nontraditional credit
All firms												
1998	55.0	27.7	13.2	20.5	9.9	10.6	9.8	28.1	46.0	34.1	61.9	89.5
Number of employees												
0-1	32.8	13.4	6.6	12.8	3.8	3.3	5.8	17.5	44.9	19.2	42.7	N/A
2-4	49.8	20.8	12.5	16.9	8.3	7.4	9.4	26.3	46.8	28.5	56.9	N/A
5-9	68.5	34.1	16.2	26.9	14.5	14.3	9.2	27.5	44.0	41.9	71.1	N/A
10-19	78.0	50.6	19.9	32.6	14.0	23.2	14.7	34.2	50.4	51.4	77.9	N/A
20-49	83.8	59.1	21.1	32.0	23.0	21.7	20.1	33.7	39.5	55.6	80.7	N/A
50-99	86.9	62.7	26.3	34.5	20.3	31.8	20.9	36.0	30.3	56.5	80.7	N/A
100-499	92.0	74.8	18.8	29.9	24.7	27.7	22.8	28.8	23.0	59.7	83.4	N/A

Note: Data are weighted to adjust for differences in sampling and response rates and reflect population rather than sample measures. Details may not sum to totals because of rounding.

Source: Federal Reserve Board, Survey of Small Business Finances, 1998 and 2003.

Table 2.6. Distribution of the Total Outstanding Dollar Amount of Traditional Types of Credit Used by Small Businesses, by Type of Supplier and Selected Category of Firm, 1998 and 2003 (Percentage of Firms)

	2003					1998			
		Nonbank					Nonbank		
Category of firm	Commercial bank	Any	Financial depository	Financial nondepository	Nonfinancial	Commercial bank	Nonbank total	Financial nondepository	Nonfinancial
All firms	56.8	43.2	6.9	27.9	8.5	65.2	34.8	23.0	7.9
Number of employees									
0-1	63.1	36.9	11.5	20.8	4.6	40.8	59.2	47.1	4.8
2-4	40.8	59.2	10.7	44.7	3.8	59.5	40.5	19.1	13.6
5-9	70.5	29.5	5.6	18.5	5.4	77.4	22.6	11.6	6.6
10-19	65.8	34.2	10.9	16.7	6.6	65.9	34.1	24.6	6.2
20-49	53.1	46.9	10.2	26.8	9.8	56.0	44.0	25.5	12.3
50-99	55.7	44.3	2.2	38.2	3.9	66.7	33.3	24.4	6.0
100-499	57.4	42.6	1.4	21.8	19.5	69.8	30.2	23.3	6.2
Fiscal year sales (thousands of dollars)									
Less than 25	46.5	53.5	29.9	15.6	8.0	32.4	67.6	42.6	18.0
25-49	57.9	42.1	19.3	17.0	5.8	64.1	35.9	19.3	5.9
50-99	22.5	77.5	6.7	67.8	2.9	35.1	64.9	33.7	14.6
100-249	39.0	61.0	35.8	14.2	11.1	57.3	42.7	23.2	11.2
250-499	61.7	38.3	16.1	15.5	6.7	70.5	29.5	12.4	12.6
500-999	57.8	42.2	6.1	27.3	8.8	63.3	36.7	22.5	7.9
1,000-2,499	60.6	39.4	7.3	27.5	4.6	54.7	45.3	28.8	9.6
2,500-4,999	59.2	40.8	5.1	31.6	4.0	68.0	32.1	14.4	13.4
5,000-9,999	59.1	40.9	3.1	32.9	4.9	69.9	30.1	23.4	4.4
10,000 or more	57.5	42.5	1.0	27.6	13.8	71.7	28.3	24.8	3.2

Notes: Data are weighted to adjust for differences in sampling and response rates and reflect population rather than sample measures. Details may not sum to totals because of rounding.

Source: Federal Reserve Board, Survey of Small Business Finances, 1998 and 2003.

Table 2.7 Distribution of the Total Outstanding Dollar Amount of Traditional Types of Credit Used by Small Businesses, by Type of Credit and Selected Category of Firm, 2003 (percent of firms)

	2003						1998					
Category of firm	Credit line	Mortgage loan	Vehicle loan	Equipment loan	Capital lease	Other traditional type	Credit line	Mortgage loan	Vehicle loan	Equipment loan	Capital lease	Other traditional type
All firms	31.7	39.0	5.1	7.2	3.2	13.7	34.1	35.1	5.5	9.6	5.8	9.9
Number of employees												
0-1	24.5	51.2	10.5	2.6	1.1	10.0	9.8	70.3	6.5	2.0	1.8	9.6
2-4	16.1	65.5	5.6	4.8	1.0	7.0	18.9	49.8	11.5	4.7	4.9	10.2
5-9	47.3	32.0	7.0	5.2	1.0	7.6	32.5	43.7	6.4	5.8	4.0	7.7
10-19	19.3	46.0	5.0	5.5	1.3	22.8	32.7	32.7	6.7	10.1	9.8	8.0
20-49	29.9	42.6	5.9	7.9	2.5	11.1	32.6	21.5	4.8	18.3	7.0	15.8
50-99	42.7	23.0	2.8	6.3	14.1	11.2	35.7	42.3	3.5	6.7	6.9	5.0
100-499	38.5	21.6	3.4	13.3	1.3	22.0	47.2	22.0	3.4	11.6	4.2	11.7
Fiscal year sales (thousands of dollars)												
Less than 25	10.4	46.6	7.1	1.8	0.8	33.2	13.1	42.1	5.6	1.5	31.1	6.6
25-49	8.3	47.5	11.6	1.0	1.8	29.7	9.4	65.7	9.9	5.8	1.7	7.5
50-99	7.1	78.3	8.9	2.9	1.0	1.8	9.4	52.0	13.2	3.9	11.6	9.9
100-249	16.2	56.2	10.2	5.2	2.5	9.6	15.3	52.6	9.1	5.8	5.1	12.2
250-499	14.6	55.1	6.8	3.8	1.1	18.6	24.7	43.9	9.7	5.9	6.4	9.4
500-999	15.4	49.2	10.1	11.4	1.5	12.4	17.0	60.1	6.0	6.0	4.8	6.1
1,000-2,499	38.4	40.5	5.1	6.5	1.2	8.4	18.8	39.4	8.8	11.0	7.7	14.4
2,500-4,999	29.2	47.9	4.4	8.1	2.9	7.6	32.4	32.1	4.2	13.7	6.7	11.0
5,000-9,999	17.9	42.1	4.1	6.7	16.2	13.0	33.8	25.7	5.3	12.2	9.6	13.5
10,000 or more	49.7	21.0	2.2	8.4	1.0	17.7	54.1	22.3	2.8	10.3	2.5	8.0

Note: Data are weighted to adjust for differences in sampling and response rates and reflect population rather than sample measures. Details may not sum to totals because of rounding.

Source: Federal Reserve Board, Survey of Small Business Finances, 1998 and 2003.

Small Business Borrowing

Small business credit continued to expand in 2006 because of favorable economic conditions as well as a financial market supplied with ample liquidity. Aside from corporate borrowing for mergers and acquisitions, demand for other loan types weakened slightly toward the end of the year as lenders tightened their lending criteria. Although financing was available to small firms, borrowing costs continued to rise in 2006; average rates for the smallest, fixed-rate term loans (valued at less than $100,000) reached 8.76 percent in November 2006 (see Table 2.1).

Developments in Small and Micro Business Lending[3]

The pace of borrowing from lending institutions picked up from the previous year, and small business loans of less than $1 million by depository institutions showed larger increases between June 2005 and June 2006 than in the previous period. The dollar amount of all small business loans outstanding increased 5.5 percent, from $601 billion in June 2005 to $634 billion in June 2006 (Tables 2.8, 2.9, and 2.10.) Small business loans of all sizes increased during this period; loans under $100,000 and loans from $100,000 to $1 million increased by 5.5 percent. The increase is confirmed by the larger increases in the number of larger small business loans ($100,000 to $1 million), up 12.8 percent over the June 2005 to June 2006 period compared with almost no change, or a very slight drop, for loans under $100,000 (Table 2.10). The largest increase in business borrowing during this period was in large corporations, which continued to increase investment, as corporate merger and acquisition activities, especially by private equity funds, accelerated the pace of leveraged buyouts in 2006. Borrowing by larger corporations in loans over $1 million increased at an annual rate of 12.4 percent, compared with an increase of 11.1 percent over the previous period.

Bank consolidations continued during the June 2005–June 2006 period, as indicated by the continued increase in the multibillion-dollar lending institutions' share of total industry assets (Table 2.11).[4] The number of multibillion-dollar lending institutions with total domestic assets of more than $10

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3 Lending institutions include commercial banks, federal savings banks, and savings and loan associations, but exclude credit unions.

4 The number of lending institutions as of June 2006 was 7,563 including 1,487 independent institutions and 5,076 bank and financial services holding companies.

Table 2.8 Dollar Amount and Number of Small Business Loans by Loan Size, June 2003–June 2006, (dollars in billions, numbers in millions)

Loan Size	2003		2004		2005		2006		Percent change June 2005–June 2006
	Dollars	Number	Dollars	Number	Dollars	Number	Dollars	Number	
Under $100,000	136.8	17.14	135.9	15.24	138.4	19.0	146.0	19.0	5.5
$100,000 to under $1 million	411.5	1.77	441.3	1.89	462.3	1.98	487.9	2.23	5.5
Under $1 million	548.1	18.91	577.1	17.13	600.8	21.00	634.0	21.3	5.5
Total business loans (dollars)	1,446.0		1,512.6		1,680.8		1,848.4		10.0

Source: U.S. Small Business Administration, Office of Advocacy, *Small Business Lending in the United States*, various years, and special tabulations of the June 2006 call reports (Consolidated Reports of Condition and Income for U.S. Banks and Thrift Institutions) prepared for the Office of Advocacy by James Kolari, Texas A&M University, College Station, Texas.

Table 2.9 Change in the Dollar Amount of Business Loans by Loan Size, June 2003–June 2006 (percent)

Loan size	June 2003–June 2004	June 2004–June 2005	June 2005–June 2006
Under $100,000	-0.5	1.9	5.5
$100,000 to under $1 million	7.2	4.8	5.5
Under $1 million	5.3	4.1	5.5
Over $1 million	4.6	11.1	12.4

Source: U.S. Small Business Administration, Office of Advocacy, *Small Business Lending in the United States*, various years, and special tabulations of the June 2006 call reports (Consolidated Reports of Condition and Income for U.S. Banks and Thrift Institutions) prepared for the Office of Advocacy by James Kolari, Texas A&M University, College Station, Texas.

Table 2.10 Change in the Number of Small Business Loans by Loan Size, June 2003–June 2006 (percent)

Loan size	June 2003–June 2004	June 2004–June 2005	June 2005–June 2006
Under $100,000	-11.1	24.8	0
$100,000 to under $1 million	6.6	5.0	12.8
Under $1 million	-9.4	22.6	1.2

Source: U.S. Small Business Administration, Office of Advocacy, *Small Business Lending in the United States*, various years, and special tabulations of the June 2006 call reports (Consolidated Reports of Condition and Income for U.S. Banks and Thrift Institutions) prepared for the Office of Advocacy by James Kolari, Texas A&M University, College Station, Texas.

billion increased from 101 in June 2005 to 108 in June 2005; they accounted for 75.2 percent of total domestic assets, 64 percent of total business loans, and 45 percent of small business loans. Again, the largest lenders continued to increase their dominance in the market for loans under $100,000, especially in the business credit card market, where they accounted for 71 percent of the total number and 53 percent of the total amount of these loans in June 2006 (Table 2.11).

In the market for loans between $100,000 and $1 million, the largest lenders remained relatively passive or at least not aggressive. Their shares in this market remained almost unchanged, in both the amount and number of loans, in spite of their increased asset share.

Lending by Finance Companies

Lending to businesses by finance companies expanded in 2006, as business receivables outstanding increased by 4.0 percent from $479 billion to

Table 2.11 Share of Total Assets and Business Loans by Size of All U.S. Depository Institutions, June 2003–June 2006 (percent, except figures for number of institutions)*

		Asset size of institutions						
		Over $50 billion	$10 billion to $50 billion	Over $10 billion	$1 billion to $10 billion	$500 million to $1 billion	Under $500 million	All institutions and bank holding companies
June 30, 2004								
Number of institutions		26	78	104	430	491	6,712	7,737
Micro business loans (under $100,000)	Amount	32.22	17.03	49.25	13.85	6.43	30.46	100.0
	Number	47.93	21.53	69.47	13.92	6.32	10.29	100.0
Small business loans ($100,000-under $1 million)	Amount	26.93	16.41	43.33	20.92	9.12	26.63	100.0
	Number	26.50	16.02	42.52	20.46	10.49	26.53	100.0
Total small business loans (under $1 million)	Amount	28.17	16.56	44.73	19.26	8.49	27.53	100.0
	Number	45.57	20.93	66.50	14.64	6.78	12.08	100.0
Total business loans	Amount	44.03	17.49	61.52	18.10	5.95	14.43	100.0
Total domestic assets	Amount	53.93	18.87	72.80	13.33	3.85	10.02	100.0
June 30, 2005								
Number of institutions		31	70	101	449	541	6,533	7,624
Micro business loans (under $100,000)	Amount	36.49	13.33	49.82	15.05	6.62	28.51	100.0
	Number	52.00	17.98	69.98	13.86	8.83	7.33	100.0
Small business loans ($100,000-under $1 million)	Amount	30.23	11.76	41.99	21.96	9.95	26.10	100.0
	Number	30.72	11.33	42.05	21.25	9.35	27.36	100.0
Total small business loans (under $1 million)	Amount	31.67	12.13	43.80	20.37	9.18	26.65	100.0
	Number	49.99	17.35	67.34	14.55	8.88	9.22	100.0
Total business loans	Amount	48.99	13.39	62.37	18.18	6.11	13.33	100.0
Total domestic assets	Amount	58.77	15.00	73.77	13.06	3.92	9.25	100.0

June 30, 2006								
Number of Institutions		34	74	108	473	591	6391	7563
Micro business loans (under $100,000)	Amount	38.98	13.67	52.65	14.55	7.07	25.63	100.0
	Number	53.11	17.74	70.85	12.44	9.47	7.23	100.0
Small business loans ($100,000-under $1 million)	Amount	30.29	11.99	42.28	22.46	10.17	25.00	100.0
	Number	27.48	10.36	37.84	20.37	8.79	33.00	100.0
Total small business loans (under $1 million)	Amount	32.30	12.37	44.67	20.66	9.45	25.22	100.0
	Number	50.42	16.96	67.38	13.28	9.4	9.94	100.0
Total business loans	Amount	50.68	13.33	64.02	17.56	6.12	12.31	100.0
Total domestic assets	Amount	60.88	14.35	75.23	12.25	3.96	8.56	100.0

* All members of a holding company are consolidated to the extent the linked IDs permit. Credit unions are excluded.
Source: U.S. Small Business Administration, Office of Advocacy, *Small Business Lending in the United States*, various years, and special tabulations of the June 2006 call reports (Consolidated Reports of Condition and Income for U.S. Banks and Thrift Institutions) prepared for the Office of Advocacy by James Kolari, Texas A&M University, College Station, Texas.

$498 billion (Table 2.12). The growth of finance companies continues to be dominated by the banking industry. Lack of data from finance companies by borrowing size prevents further exploration into the distributions of loans to small and large businesses. As a result, little can be said regarding the lending patterns of finance companies and the extent to which they are lending to small businesses relative to large businesses.[5]

Small Business Investment

Equity Borrowing in the Public Issue Markets

The U.S. stock markets came alive and stock prices rose significantly in September 2006, after almost three quarters of sluggish activities, when investors' fears of an economic slowdown or even a downturn were dispelled by record earnings of U.S. corporations. While the number of initial public offerings (IPOs) declined slightly from the previous year's level, the volume increased—indicating an increased average offering size in 2006. The value of total IPO offerings increased by 20 percent from $38.0 billion in 2005 to $46.0 billion in 2006 (Table 2.13). The average offering size increased modestly from $181.6 million in 2005 to $221.6 million in 2006. IPO offerings by issuers with $25 million or less in assets before public issue increased the most, by 41.2 percent, from $815 million in 2005 to $1.2 billion in 2006. The average offering size for this category also increased by $25 million—or 64 percent—from $38.8 million the previous year to $64.0 million in 2006.

Venture Capital

The number of venture capital funds raising money decreased to 206 in 2006 from 215 in 2005, but the amount of capital raised increased to $29.9 billion. This was the highest total since 2001, but just an 8.0 percent increase since 2005 (Table 2.14). However, commitments to venture capital funds represented 19.6 percent of the total private equity capital commitment of $152.4 billion in 2006.[6] The number of companies receiving venture funds increased from 2,646 in 2005 to 2,910 in 2006. The amount of venture-backed IPOs

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5 The 2003 SSBF should provide a better understanding of the role finance companies played in the small business loan market.

6 Private equity includes venture capital and mezzanine capital. See *National Venture Capital Association Yearbook 2007*, Figure 2.02, Capital Commitments.

Table 2.12 Business Loans Outstanding from Finance Companies, December 31, 1980-December 31, 2006

	Total receivables outstanding		
	Billions of dollars	Change (percent)	Annual change in chain-type* price index for GDP (percent)
December 31, 2006	498.2	4.0	2.9
December 31, 2005	479.2	1.5	3.5
December 31, 2004	471.9	3.2	4.2
December 31, 2003	457.4	0.5	2.7
December 31, 2002	455.3	1.9	1.6
December 31, 2001	447.0	-2.5	0.8
December 31, 2000	458.4	16.3	3.7
December 31, 1999	405.2	16.6	4.5
December 31, 1998	347.5	9.1	4.2
December 31, 1997	318.5	2.9	4.5
December 31, 1996	309.5	2.6	3.7
December 31, 1995	301.6	9.7	2.4
December 31, 1994	274.9	NA	2.5
December 31, 1993	294.6	-2.3	2.3
December 31, 1992	301.3	1.9	2.5
December 31, 1991	295.8	0.9	2.6
December 31, 1990	293.6	14.6	3.4
December 31, 1989	256.0	9.1	4.6
December 31, 1988	234.6	13.9	3.9
December 31, 1987	206.0	19.7	4.0
December 31, 1986	172.1	9.3	3.2
December 31, 1985	157.5	14.3	2.5
December 31, 1984	137.8	21.9	3.5
December 31, 1983	113.4	12.9	3.8
December 31, 1982	100.4	0	5.3
December 31, 1981	100.3	11.1	8.5
December 31, 1980	90.3		

* Changes from the fourth quarter of the previous year.
NA = Not available.
Source: Board of Governors of the Federal Reserve System, Federal Reserve Bulletin, Tables 1.51 and 1.52 (various issues); U.S. Department of Commerce, Bureau of Economic Analysis, *Business Conditions Digest* (various issues) and *Survey of Current Business* (various issues).

Table 2.13 Common Stock Initial Public Offerings by All Issuers and Small Issuers, 1995-2006

	Common stock		
	Number	Amount (millions of dollars)	Average size (millions of dollars)
Offerings by all issuers			
2006	208	46,084.4	221.6
2005	211	38,317.9	181.6
2004	248	47,936.7	193.3
2003	85	16,087.3	189.3
2002	86	25,716.3	299.0
2001	99	37,526.0	379.1
2000	387	60,871.0	157.3
1999	512	63,017.4	123.1
1998	366	38,075.3	104.0
1997	623	45,785.0	73.5
1996	850	52,190.3	61.4
1995	570	32,786.1	57.5
Offerings by issuers with assets of $25 million or less			
2006	18	1,151.2	64.0
2005	21	815.1	38.8
2004	32	1,528.7	47.8
2003	8	532.3	66.5
2002	11	420.4	38.2
2001	14	477.2	34.1
2000	56	3,323.9	59.4
1999	207	10,531.0	50.9

1998	128	4,513.7	35.3
1997	241	5,746.1	23.8
1996	422	10,642.0	25.2
1995	248	5,603.1	22.6
Offerings by issuers with assets of $10 million or less			
2006	7	528.3	75.5
2005	9	400.1	44.5
2004	15	622.7	41.5
2003	4	34.8	8.7
2002	5	160.9	32.2
2001	5	54.9	11.0
2000	13	407.2	31.3
1999	87	3,556.9	40.9
1998	62	2,208.0	35.6
1997	132	2,538.6	19.2
1996	268	5,474.4	20.4
1995	159	2,545.2	16.0

Note: Excludes closed end funds. Registered offerings data from the Securities and Exchange Commission are no longer available: data provided by Securities Data Company are not as inclusive as data on businesses registered with the SEC.

Source: Special tabulations prepared for the U.S. Small Business Administration, Office of Advocacy, by Thomson Financial Securities Data, May 2007.

Table 2.14 New Commitments, Disbursements, and Total Capital Pool of the Venture Capital Industry, 1982-2006 (billions of dollars)

	Commitment	Disbursement	Initial round	Follow-on	Capital under management
2006	29.9	25.9	5.90	20.00	235.8
2005	27.8	22.8	5.30	17.10	265.4
2004	19.2	22.1	4.40	16.60	260.7
2003	11.6	19.7	3.60	15.30	255.2
2002	9.2	21.8	4.50	17.20	256.2
2001	38.2	40.7	7.50	33.40	255.8
2000	105.9	105.0	29.00	76.90	227.8
1999	58.2	54.4	16.08	38.36	145.9
1998	30.4	21.2	7.30	13.94	91.4
1997	18.2	14.8	4.72	10.06	63.2
1996	11.6	11.5	4.29	7.26	49.3
1995	10.0	7.7	3.65	4.10	40.7
1994	7.8	4.2	1.73	2.47	36.1
1993	3.8	3.9	1.43	2.41	32.2
1992	5.1	3.6	1.27	2.11	30.2
1991	1.9	2.2	0.56	1.67	29.3
1990	3.3	2.8	0.84	1.97	31.4
1989	5.4	3.3	0.98	2.32	30.4
1988	4.4	3.3	1.03	2.23	27.0
1987	4.8	4.5	0.94	2.23	24.6
1986	3.7	4.1	0.89	2.09	20.3
1985	3.1	3.4	0.71	2.01	17.2
1984	3.2	3.3	0.86	2.09	13.9
1983	4.2	3.1	0.90	1.97	10.6
1982	2.0	1.8	0.59	1.00	6.7

Source: Venture Capital Journal (various issues); *National Venture Capital Association Yearbook* 2007.

also increased, along with the average offering value. However, the number of venture-backed merger and acquisition transactions decreased from 347 in 2005 to 336 in 2006.

The angel investor market continued to provide hope of financing for new ventures as the market grew steadily in 2006 with total investments at $25.6 billion, a 10.8 percent increase from 2005 based on the Center for Venture Research, University of New Hampshire. The average deal size increased by 7.5 percent compared with 2005.[7] The largest source of seed and start-up capital came from angel investors (46 percent), who are also becoming actively involved in more later-stage investments because of the capital gap in the market. Entrepreneurial ventures receiving angel funding increased by 3.0 percent, from 49,500 in 2005 to 51,000 in 2006.

Conclusion

Overall, the economy continued to grow as household wealth increased and consumer spending remained strong in 2006. Financing was available to small firms, but the cost of interest rates remained high as the Federal Reserve Board maintained a firm stance on interest rate policy.

Business borrowing was strong, while household borrowing slowed. Borrowing by nonfarm, noncorporate businesses also declined slightly, by $15 billion in 2006. Small businesses continued to use various sources for both internal and external financing. The use of credit lines by small businesses continues to increase as very large lenders persistently promote credit cards to this market segment.

Equity markets grew at a moderate pace, and the average offering size in the IPO market increased, while the number of IPOs dipped slightly. IPO offerings by medium-sized companies increased the most during this period, while IPOs backed by merger and acquisition ventures remained quite active. The economy overall remained strong as consumer confidence increased by year's end.

7 Jeffrey Sohl, professor, Whittemore School of Business and Economics, and director, University of New Hampshire, Center for Venture Research.

3 Federal Procurement *from* Small Firms

Synopsis

Small businesses, numbering nearly 27 million, continue to have a strong foothold in the American economy. According to the U.S. Small Business Administration, Office of Advocacy's most recent *Frequently Asked Questions,* based in large part on Census data, small businesses represent 99.7 percent of all employer firms.[1] They create more than one-half of the nonfarm private gross domestic product, make up 97 percent of all identified exporters, and produced 28.6 percent of the known export value in FY 2004.

Small businesses also hire 40 percent of high technology workers (such as scientists, engineers, and computer workers)—important because the hiring is done by small firms on the cutting edge of technological developments. Small businesses produce 13 times more patents per employee than large patenting firms, and their patents are twice as likely to be among the one percent most cited.[2]

The Small Business Innovation Research (SBIR) program, over its 24-year existence, has become one of the most productive programs for small businesses and thus for the nation's competitive advantage in world markets. Armor Works and Hawaii Biotech are two examples. Armor Works used SBIR funding to develop innovative technologies such as a high-performance composite armor. Armor Works's advanced composite armor technology is already commercialized and in production for body, vehicle, and aircraft armor used by all branches of the U.S. military.[3] Hawaii Biotech has developed vaccines for emerging infectious diseases that include seasonal and avian (pandemic) influenza, West Nile encephalitis, and dengue fever. Its proprietary manufacturing platform, which exploits recombinant DNA technology to produce commercially scaleable, ultra-high quality vaccine components, is

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1 See http://app1.sba.gov/faqs/faqIndexAll.cfm?areaid=24.

2 *Foreign Patenting Behavior of Small and Large Firms: An Update,* prepared by Mary Ellen Mogee under contract with the U.S. Small Business Administration, Office of Advocacy (Springfield, VA: National Technical Information Service, 2003), http://www.sba.gov/advo/research/rs228_tot.pdf.

3 See http://www.sbirworld.com/federalAgencyLinks.asp?mnuFed=1.

suited to produce vaccines in the quantities and timeframes needed to protect human populations.[4]

The federal government is one of the largest single sources of U.S. contracting opportunities for small businesses. In fiscal year (FY) 2006, more than $340 billion in contracts were identified as small business-eligible. The Small Business Administration (SBA) reported that small businesses received more than $77 billion in direct prime contract awards. Subcontract data are being revised, but it is estimated that small firms received subcontracts worth about $65 billion, for an FY 2006 total of $142 billion in federal small business contract dollars.[5]

At the forefront of President Bush's Small Business Agenda, first announced in 2002, have been efforts to provide greater transparency in federal small business procurement. A number of recent changes have been implemented, including new guidance for large businesses subcontracting to small firms, improvements in small business size standards, clarification of the "novation" regulations relating to small businesses acquired by larger ones, initiatives toward more transparency in federal procurement data, and steps to reduce the contract bundling that can leave small firms out of the competition.

Additional developments that occurred in 2004, 2005, and 2006 deserve mention. First, in 2004, the General Services Administration and the Office of Management and Budget, Office of Federal Procurement Policy (OMB/OFPP) introduced the fourth generation of the Federal Procurement Data System-Next Generation (FPDS-NG). Work is ongoing to correct problems in the quality, timeliness, and accuracy of the data under the new system. The new FPDS-NG was designed to reduce the potential for human error in transferring data to the FPDS. When the system becomes 100 percent operational, small business stakeholders are expected to be able to retrieve federal small business procurement numbers in real time and make policy and marketing decisions more quickly and accurately.[6]

Second, in April 2005, the SBA introduced changes to the Central Contractor Registration (CCR) process, using its Small Business Logic program to determine the small business status of companies registered in the

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4 Id.

5 For more detailed data, see http://www.sba.gov/aboutsba/sbaprograms/goals/index.html. These data will be discussed in detail below.

6 See Amendment 2004-04, General Services Acquisition Regulations (GSAR) Case 2004-G509, Access to the Federal Procurement Data System, December 28, 2004.

CCR. This is expected to improve accuracy and transparency, and to reduce previously required data input. Companies are no longer required to fill out the SBA-certified business type fields for small disadvantaged, 8(a), and HUBZone businesses; those will be automatically filled in by SBA. The SBA will further validate business size, based on the number of employees and revenue data provided to the CCR.[7]

Third, the Service Acquisition Advisory Panel authorized by Section 1423 of the Services Acquisition Reform Act of 2003 has finalized its report.[8] The panel's statutory charter was to review and recommend to Congress and the administration specific actions that should further the enhancement of procurement opportunities for small businesses. Further, it was to review and recommend any necessary changes to acquisition laws and regulations, as well as government-wide acquisition policies, with a view toward ensuring effective and appropriate use of commercial practices and performance-based contracting.[9] The panel extended the deadline for its final report by six months. SBA was represented on the panel and chaired the small business group. Some of the recommendations, when implemented, will help to further the intent of President Bush's Small Business Agenda (leveling the playing field for small businesses to compete in the federal marketplace).[10]

Small Business Procurement Data

An Advocacy-sponsored study published in December 2004, *Analysis of Type of Business Coding for the Top 1,000 Contractors Receiving Small Business Awards in FY 2002,* found coding problems with small business contracts.[11] The coding problems pertained to a number of companies found to be other than small in the FY 2002 procurement data. The coding issues could have resulted from errors in the companies' size identification or from companies growing to—or having been acquired by—larger businesses during the course of the contract.

7 Information on CCR is available at http://www.ccr.gov/.

8 See Section 843 of Title VIII of the National Defense Authorization Act for Fiscal Year 2006, Public Law 109-163.

9 The membership of the panel consisted of experts in government acquisition law and policy, representing a variety of backgrounds from both the public and private sectors.

10 See http://acquisition.gov/comp/aap/index.html.

11 The report is available at http://www.sba.gov/advo/research/rs246tot.pdf .

Efforts by the SBA and the OFPP to achieve greater transparency in federal procurement data continue. In fact, as part of the solution for the problems associated with miscoding, SBA revised its small business procurement goaling numbers by going through a thorough certification and data review process. Consequently, the FY 2005 goaling achievement has been reduced from the previous 25.4 percent to 23.4 percent. This revised percentage represents an increase of .4 percent above the federal government-wide goal of 23 percent. In dollars, this reduction represents a decrease of $4.6 billion. The original FY 2005 dollar level was $79.6 billion. The revised level is $75 billion or 23.4 percent.[12]

In another significant effort to improve the quality of federal procurement data, OFPP Administrator Paul Denett, in a March 9, 2007, memorandum to agency chief acquisition officers, required that they establish agencywide, statistically valid, procurement data verification and validation procedures and provide a certification of data accuracy and completeness each year. The first report is due December 15, 2007.[13]

An SBA Procurement Scorecard was recently introduced by SBA and OFPP to facilitate public review of the procurement database. According to OFPP Administrator Denett, "This new tool, along with better data in the goaling reports, will enable us to identify where we are strong and where we need to improve." SBA rates 24 agencies green, yellow, or red, based on whether they reached their annual small business contracting goals and on their progress in efforts to make contracting opportunities available to small businesses.[14]

SBA's recertification regulation became effective on June 30, 2007. This regulation is another attempt by SBA to reduce the inaccuracies of counting businesses as small. The regulation requires a small business holding a contract for more than five years to recertify its size status after the fifth year and any option extension thereafter.[15] Historically, SBA's regulations called for determination of small business size status when firms submitted their initial offers. Firms maintained their size status for the duration of contracts.

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12 See www.sba.gov/gc/goals.

13 See http://www.whitehouse.gov/omb/procurement/memo/fpds_ltr_030907.pdf. (Accessed September 25, 2007).

14 The scorecard is available at www.sba.gov.

15 See www.sba.gov/gc.

Expanding the ongoing efforts of SBA to improve the accessibility, quality, and transparency of data, Congress passed and President Bush signed into law the Federal Funding Accountability and Transparency Act of 2006, Public Law 109-282. The law will require all contractors and subcontractors to report their federal dollar expenditures, as well as contract and grant dollars; this information will become part of a searchable website that provides public access to information about federal expenditures.

Federal Contracting with Small Firms in FY 2006

In FY 2006, the dollar amount in contracts available for small business participation totaled $340 billion, and the percentage awarded to small businesses was 22.8 percent (Table 3.1). Of the $340 billion total in FY 2006, small businesses were the recipients of $77.7 billion in direct prime contract dollars, up from the revised $75 billion in FY 2005, according to SBA.[16]

Subcontracting statistics have not been available for several years because of the migration to the Electronic Subcontracting Report System (ESRS). ESRS is now in full operation, except in the Department of Defense (DOD), which has not yet officially migrated. In FY 2005, small businesses were awarded nearly $60 billion in subcontracts. The FY 2006 subcontracting data are being revised, but it is estimated that small businesses will receive about $65 billion in subcontracting dollars.[17] In sum, small businesses were awarded slightly more than $142 billion in total contract dollars in FY 2006.

16 The following disclaimers to the FY 2005 Small Business Goaling Report appear on the Small Business Administration's Office of Government Contracting website (http://www.sba.gov/GC/goals/index05.html). "Fiscal Year 2005 is the second year the FPDS-NG has produced the Small Business Goaling Report. There are three issues identified in this year's report. One is government-wide; the other two are agency-specific. Government-wide: 'The FY 2005 Small Business Goaling Report does not provide 8(a) credit for delivery orders against Indefinite Delivery Vehicles (IDVs). This issue will be fixed in time for the FY 2006 report.' USAID [U.S. Agency for International Development] specific: 'USAID is still in the process of entering their FY05 data into FPDS-NG; therefore this report is not a complete reflection of their small business achievement. USAID is working diligently to enter their data, and expect to be finished by the end of this summer.' DOD specific: 'The number of actions reported is fewer than it should be because DOD consolidates certain actions into single contract reports. This does not affect the dollar amount or small business percentages.'"

17 See www.sba.gov/goals.

Table 3.1 Total Federal Prime Contract Dollars, FY 2004-FY 2006

Fiscal year	Thousands of dollars: Total	Thousands of dollars: Small business	Small business share (percent)
2006	340,212,001	77,670.193	22.82
2005	320,309,252	75,000,000	23.41
2004	299,886,098	69,228,771	23.09

Note: In 2004, the GSA and the OMB/OFPP introduced the fourth generation of the FPDS. The FPDS-NG data shown here, unless otherwise noted, reflect all contract actions available for small business competition (excluding some categories), not just those over $25,000.

Source: General Services Administration, Federal Procurement Data System.

Sources of Small Business Awards by Department/Agency

The largest share of all federal purchases in contracts has historically come from DOD (Tables 3.2-3.4). DOD's share of overall procurement dollars reached about 70 percent in both FY 2004 and 2005 (Table 3.2). In FY 2006, DOD awarded small businesses $51.3 billion in contract dollars—21.8 percent of the Defense Department total of more than $234.9 billion, according to the SBA (Table 3.4). Of the $77.7 billion awarded to small businesses by all federal agencies, 66.1 percent were in DOD awards (Table 3.3).

The next largest source of federal contracting dollar awards to small businesses was the Department of Homeland Security, which awarded $4.4 billion or 31.6 percent of its contract dollars to small businesses in FY 2006. Third was the Department of Veterans Affairs, which awarded $2.9 billion or 28.7 percent to small businesses. The Department of Housing and Urban Development again sent the largest share of its contracting dollars to small firms—66.3 percent of its $1.1 billion total, or $744.4 million (Table 3.4).

Small Business Innovation Research

The Small Business Innovation Development Act requires the federal departments and agencies with the largest extramural research and development (R&D) budgets to award a portion of their R&D funds to small businesses.[18] Ten government agencies with extramural research and development obligations over $100 million initially participated in this program: the Departments of Agriculture, Commerce, Defense, Education, Energy, Health and Human Services, and Transportation, and the Environmental Protection Agency, the National Aeronautics and Space Administration, and the National Science

18 Public Law 97-219, Public Law 102-564.

Table 3.2 Procurement Dollars in Contract Actions over $25,000 by Major Agency Source, FY 1984-FY 2003, and in Total, FY 2004-FY 2006

Fiscal year	Total (thousands of dollars)	Percent of total			
		DOD	DOE	NASA	Other
2006*	340,212,001	66.1	1.5	2.5	29.9
2005*	320,309,252	69.7	7.3	3.9	19.1
2004*	299,886,098	70.3	7.3	4.2	18.2
2003	292,319,145	67.9	7.2	4.0	20.9
2002	258,125,273	65.1	7.4	4.5	23.1
2001	248,985,613	58.2	7.5	4.5	29.8
2000	207,401,363	64.4	8.2	5.3	22.2
1999	188,846,760	66.4	8.4	5.8	19.4
1998	184,178,721	64.1	8.2	5.9	21.8
1997	179,227,203	65.4	8.8	6.2	19.5
1996	183,489,567	66.5	8.7	6.2	18.7
1995	185,119,992	64.3	9.1	6.3	20.2
1994	181,500,339	65.4	9.9	6.3	18.4
1993	184,426,948	66.7	10.0	6.4	16.8
1992	183,081,207	66.3	10.1	6.6	16.9
1991	193,550,425	70.2	9.5	6.1	14.2
1990	179,286,902	72.0	9.7	6.4	11.9
1989	172,612,189	75.0	8.8	5.7	10.6
1988	176,544,042	76.9	8.2	4.9	10.0
1987	181,750,326	78.6	7.7	4.2	9.5
1986	183,681,389	79.6	7.3	4.0	9.0
1985	188,186,597	80.0	7.7	4.0	8.3
1984	168,100,611	79.3	7.9	4.0	9.0

*In 2004, the General Services Administration and the Office of Federal Procurement Policy (OMB/OFPP) introduced the fourth generation of the FPDS. The FPDS-NG data shown here for FY 2004 –FY 2006 reflect all contract actions available for small business competition (excluding some categories) not just those over $25,000. The figures are not strictly comparable with those shown for previous years.
Note: Percentages shown are the agencies' percentages of total contract dollars, not just small business contract dollars. See Table 3.3 for the agencies' share of dollars in small business contracts.

Source: General Services Administration, Federal Procurement Data System.

Foundation. A total of about $19.9 billion has been awarded to small businesses over the 24 years of the Small Business Innovation Research (SBIR) program (Table 3.5).[19] Participating agencies received a total of 27,572 proposals in FY 2006 and made 5,862 awards totaling $1.9 billion.

19 FY 2006 figures for the Small Business Innovation Research program are preliminary.

Table 3.3 Distribution of Small Business Share of Dollars by Procuring Agency Source, FY 2005 and FY 2006*

	Total small business (S 000)		Small business distribution (percent)		Rank	
	FY 2005	FY 2006	FY 2005	FY 2006	FY 2005	FY 2006
Total, all agencies	75,000,227	77,670,194	100.0	100.0		
Agency for International Development (1152, 7200)	73,873	51,126	0.1	0.1	21	24
Corporation for National and Community Service	13,882	10,868	0.0	0.0	38	40
Commodity Futures Trading Commission	3,253	2,976	0.0	0.0	36	38
Consumer Product Safety Commission	4,259	5,670	0.0	0.0	30	34
Department of Agriculture	2,000,017	2,032,089	2.7	2.6	5	5
Department of Commerce	973,119	1,041,421	1.3	1.3	10	11
Department of Defense	50,314,701	51,316,934	67.1	66.1	1	1
Department of Education	124,188	174,020	0.2	0.2	20	19
Department of Energy	914,524	1,206,386	1.2	1.6	11	10
Department of Health and Human Services	3,471,503	2,780,278	4.6	3.6	3	4
Department of Homeland Security	4,054,604	4,410,174	5.4	5.7	2	2
Department of Housing and Urban Development	651,621	744,377	0.9	1.0	14	13
Department of the Interior	1,495,615	1,389,190	2.0	1.8	7	8
Department of Justice	1,529,547	1,570,552	2.0	2.0	17	16
Department of Labor	528,945	575,049	0.7	0.7	12	12
Department of State	727,287	901,350	1.0	1.2	8	9
Department of Transportation	710,276	607,719	0.9	0.8	13	15
Department of the Treasury	572,901	566,812	0.8	0.7	15	17
Department of Veterans Affairs	2,015,013	2,862,900	2.7	3.7	4	3
Environmental Protection Agency	561,713	678,599	0.7	0.9	16	14
Equal Employment Opportunity Commission	11,829	11,353	0.0	0.0	31	33
Executive Office of the President	35,917	30,022	0.0	0.0	26	29

Federal Election Commission	1,978	1,444	0.0	0.0	41	42
Federal Emergency Management Agency	165,261	59,897	0.2	0.1	19	22
Federal Maritime Commission	451	577	0.0	0.0	44	43
Federal Trade Commission	1,526	15,447	0.0	0.0	42	31
General Services Administration	1,477,330	1,751,894	2.0	2.3	9	7
International Trade Commission	3,319	0	0.0	0.0	37	45
Millennium Challenge Corporation	4,896	13,767	0.0	0.0	35	32
National Aeronautics and Space Administration	1,826,962	1,938,444	2.4	2.5	6	6
National Archives and Records Administration	28,368	32,795	0.0	0.0	29	28
National Endowment for the Arts	709	1,554	0.0	0.0	43	41
National Labor Relations Board	5,937	6,145	0.0	0.0	34	36
National Mediation Board	104	2	0.0	0.0	45	44
National Science Foundation	35,674	39,367	0.0	0.1	27	26
National Transportation Safety Board	2,274	3,433	0.0	0.0	40	39
Nuclear Regulatory Commission	36,640	49,868	0.0	0.1	25	25
Office of Personnel Management	69,837	157,048	0.1	0.2	22	20
Peace Corps	9,140	29,120	0.0	0.0	32	30
Railroad Retirement Board	2,455	5,761	0.0	0.0	39	37
Securities and Exchange Commission	42,668	37,109	0.1	0.0	24	27
Small Business Administration	35,197	55,803	0.0	0.1	28	23
Smithsonian Institution	51,962	112,602	0.1	0.1	23	21
Social Security Administration	301,337	258,709	0.4	0.3	18	18
Trade and Development Agency	6,175	9,529	0.0	0.0	33	35
U.S. Information Agency	37	0	0.0	0.0	46	46

Note: The FPDS-NG data shown here reflect all contract actions available for small business competition (excluding some categories), not just those over $25,000. The figures for FY 2004 and 2005 and FY 2006 are not strictly comparable with those for previous years.

Source: General Services Administration, Federal Procurement Data System, and Global Computer Enterprises, Inc.

Table 3.4 Small Business Share of Dollars by Top 25 Major Procuring Agencies, Fiscal Years 2005 and 2006

	Contract dollars (thousands)							
	FY 2005		FY 2006		Small firm share (percent)		Share rank	
Agency	Total	Small business	Total	Small business	FY 2005	FY 2006	FY 2005	FY 2006
Total	320,309,253	75,000,227	340,212,001	77,670,194	23.4	22.8		
Agency for International Development	173,632	73,873	262,016	51,126	42.5	19.5	7	21
Department of Agriculture	3,897,402	2,000,017	4,119,558	2,032,089	51.3	49.3	3	5
Department of Commerce	1,967,376	973,119	2,097,398	1,041,421	49.5	49.7	4	4
Department of Defense	222,601,624	50,314,701	234,951,480	51,316,934	22.6	21.8	21	20
Department of Education	1,391,159	124,188	1,415,217	174,020	8.9	12.3	24	23
Department of Energy	22,877,566	914,524	22,465,121	1,206,386	4.0	5.4	25	25
Department of Health and Human Services	9,952,800	3,471,503	11,838,822	2,780,278	34.9	23.5	12	19
Department of Homeland Security	10,238,596	4,054,604	13,954,853	4,410,174	39.6	31.6	8	15
Department of Housing and Urban Development	1,086,100	651,621	1,122,217	744,377	60.0	66.3	1	1
Department of the Interior	2,714,427	1,495,615	2,503,550	1,389,190	55.1	55.5	2	3
Department of Justice	4,284,885	1,529,547	4,266,358	1,570,552	35.7	36.8	11	10
Department of Labor	1,644,366	528,945	1,736,453	575,049	32.2	33.1	16	12
Department of State	1,970,536	727,287	2,300,050	901,350	36.9	39.2	10	8
Department of Transportation	1,556,972	710,276	1,478,177	607,719	45.6	41.1	5	6
Department of the Treasury	2,005,345	572,901	1,928,622	566,812	28.6	29.4	19	16
Department of Veterans Affairs	8,503,797	2,015,013	9,972,595	2,862,900	23.7	28.7	20	18
Environmental Protection Agency	1,521,147	561,713	1,704,470	678,599	36.9	39.8	9	7

Federal Emergency Management Agency	519,780	165,261	506,498	59,897	31.8	11.8	17	24
General Services Administration	4,519,499	1,477,330	5,437,701	1,751,894	32.7	32.2	15	13
National Aeronautics and Space Administration	13,868,520	1,826,962	13,049,292	1,938,444	13.2	14.9	23	22
Nuclear Regulatory Commission	109,483	36,640	135,839	49,868	33.5	36.7	14	11
Office of Personnel Management	239,372	69,837	542,660	157,048	29.2	28.9	18	17
Securities and Exchange Commission	99,753	42,668	99,149	37,109	42.8	37.4	6	9
Smithsonian Institution	237,785	51,962	197,699	112,602	21.9	57.0	22	2
Social Security Administration	865,669	301,337	814,667	258,709	34.8	31.8	13	14

*Not ranked in 2005 report.

Note: The FPDS-NG data shown here reflect all contract actions available for small business competition (excluding some categories), not just those over $25,000. The figures are not strictly comparable with figures for previous years. All agencies are represented in the total dollars; the organizations listed are those agencies that awarded at least $35 million to small firms in FY 2006.

Source: General Services Administration, Federal Procurement Data System and Global Computer Enterprises, Inc.

The SBIR program continues to be successful not only for small businesses and participating federal agencies, but for the American public, which benefits from the new products and services developed. A number of important innovations have been developed by small businesses in the program. For example, fast flow pre-filter cartridges have 20 times greater capacity than conventional cartridges and offer extraordinary filtration efficiency and dirt holding capability. Broadband Acoustic Doppler Current Profiler (ADCP) products—ocean research instruments—are widely used by the DOD to measure physical properties of the ocean in regions of interest to the Navy. Advanced magnetometers are for use in hand-held electronic compasses that have now become consumer products, like the Wayfinder™ Electronic Automobile Compass.[20]

The success of the SBIR program has been documented by the National Research Council (NRC) of the National Academies.[21] The U.S. Congress requested a complete review of the SBIR program in the 2000 SBIR Reauthorization Act. Most of the federal agencies, including the Office of Advocacy, were given congressionally mandated roles to play in the review process. Advocacy was specifically required to provide NRC with links to the small business community. Several of the findings include the following:

- SBIR projects yield a variety of contributions to knowledge outputs.
- SBIR supports the transfer of research into the marketplace, as well as the general expansion of scientific and technical knowledge.
- SBIR awards help to advance small technology companies by developing firm-specific capabilities, and creating and marketing new commercial products and services.
- The SBIR program has been used to help meet federal research and development needs and the procurement needs of diverse federal agencies.
- The SBIR program is encouraging innovation across a broad spectrum of firms, creating additional competition among suppliers for the procurement agencies, and providing agencies new mission-oriented

20 More extensive listings of SBIR accomplishments may be seen at these web sites: DOD, http://www.dodsbir.net/SuccessStories/default.htm; National Aeronautics and Space Administration, http://sbir.nasa.gov/SBIR/successes/techcon.html; Health and Human Services (National Institutes of Health), http://grants1.nih.gov/grants/funding/sbir_successes/sbir_successes.htm.

21 The complete report is available at www.nap.edu. The National Academies include the National Research Council, the National Academy of Sciences, the National Academy of Engineering, and the Institute of Medicine.

Table 3.5 Small Business Innovation Research Program, FY 1983 - FY 2006

Fiscal year	Phase I Number of proposals	Phase I Number of awards	Phase II Number of proposals	Phase II Number of awards	Total awards (millions of dollars)
Total	459,637	68,346	54,719	26,769	19,869.01
2006*	24,305	3,836	3,267	2,026	1,883.17
2005*	26,003	4,300	4,180	1,871	1,865.90
2004	30,766	4,638	3,604	2,013	1,867.44
2003	27,992	4,465	3,267	1,759	1,670.10
2002	22,340	4,243	2,914	1,577	1,434.80
2001	16,666	3,215	2,566	1,533	1,294.40
2000	17,641	3,172	2,533	1,335	1,190.20
1999	19,016	3,334	2,476	1,256	1,096.50
1998	18,775	3,022	2,480	1,320	1,100.00
1997	19,585	3,371	2,420	1,404	1,066.70
1996	18,378	2,841	2,678	1,191	916.3
1995	20,185	3,085	2,856	1,263	981.7
1994	25,588	3,102	2,244	928	717.6
1993	23,640	2,898	2,532	1,141	698
1992	19,579	2,559	2,311	916	508.4
1991	20,920	2,553	1,734	788	483.1
1990	20,957	2,346	2,019	837	460.7
1989	17,233	2,137	1,776	749	431.9
1988	17,039	2,013	1,899	711	389.1
1987	14,723	2,189	2,390	768	350.5
1986	12,449	1,945	1,112	564	297.9
1985	9,086	1,397	765	407	199.1
1984	7,955	999	559	338	108.4
1983	8,814	686	127	74	44.5

*Preliminary estimates.

Note: Phase I evaluates the scientific and technical merit and feasibility of an idea. Phase II expands on the results and further pursues the development of Phase I. Phase III commercializes the results of Phase II and requires the use of private or non-SBIR federal funding. The Phase II proposals and awards in FY 1983 were pursuant to predecessor programs that qualified as SBIR funding.

Source: U.S. Small Business Administration, Office of Innovation, Research, and Technology (annual reports for FY 1983 – FY 2006).

research and solutions. Each year, more than one-third of the firms awarded SBIR funds participate in the program for the first time. This steady infusion of new firms is a major strength of the program.

Procurement from Minority- and Women-owned Businesses

The participation of small women- and minority-owned businesses in the federal procurement marketplace continues to grow (Tables 3.6-3.8). Small women-owned businesses' share of federal procurement dollars grew from 3.2 percent in FY 2005 to 3.4 percent in FY 2006. (Table 3.6). Small disadvantaged businesses achieved their 5 percent goal, reaching nearly 6.8 percent or $23.0 billion. Participants in the SBA 8(a) program were awarded 3.7 percent of the total FY 2006 procurement dollars or $12.5 billion.

Service-Disabled Veteran Business Owners

Service-disabled veteran business owners are now among the socioeconomic groups monitored in the federal procurement marketplace. Public Law 106-50 established a statutory goal of 3 percent of all prime and subcontracting dollars to be awarded to service-disabled veterans. Public Law 108-183 fortified this requirement by providing the contracting officer with the authority to sole source and restrict bidding on contracts to service-disabled veteran-owned small businesses. In FY 2001 they were awarded 0.25 percent of direct federal contract dollars, and in FY 2002 that percentage was less than 0.2 percent. In FY 2003 their share was $550 million or 0.2 percent, and in FY 2004 small service-disabled veteran-owned businesses were awarded contracts valued at $1.1 billion or 0.4 percent of federal contracting dollars. In FY 2006 this group was awarded more than $2.9 billion or 0.9 percent of federal procurement. Veteran-owned small businesses were awarded $8.7 billion or 2.6 percent in FY 2006. In 2006, Congress passed Public Law 109-461, which gives a single federal agency, the U.S. Department of Veterans Affairs (VA), unique and specific contracting authority that is not available to other agencies.[22]

22 This law authorizes the VA secretary to 1) establish a set-aside and sole-source award mechanism for veteran-owned small businesses (VOSB) within the VA; 2) establish a defined contracting preference for VA acquisitions with service-disabled small businesses first, followed by VOSBs; and 3) require the VA secretary to establish prime and subcontracting goals for SDVOSBs and VOSBs The SDVOSB goal cannot be less than the 3 percent required by Public Law 106-50.

Table 3.6 Prime Contract Awards by Recipient Category (billions of dollars)

	FY 2005		FY 2006	
	Dollars	Percent	Dollars	Percent
Total to all businesses	320.30	100.00	340.00	100.00
Small businesses	75.00	25.35	77.7	22.82
Small disadvantaged businesses (SDBs)	20.98	6.55	22.95	6.75
8(a) businesses	11.79	3.68	12.47	3.86
Non-8(a) SDBs	11.25	3.58	—	—
HUBZone businesses	6.18	1.93	7.16	2.10
Women-owned small businesses	10.18	3.18	11.61	3.41
Service-disabled veteran-owned small businesses	1.94	0.60	1.95	.87

— This category wsa reflected in the FPOS-NG release for FY 2005, but not for FY 2006.
Source: General Services Administration, Federal Procurement Data System.

Historically Underutilized Business Zones

Historically underutilized business zone (HUBZone) small business owners were awarded $7.16 billion or 2.1 percent of the FY 2006 procurement dollars toward the statutory HUBZone goal of 5 percent. The Office of Advocacy has been mandated by Congress to review this program and to report its findings to Congress. In addition, Public Law 108-447 authorized the selection of Base Realignment and Closure (BRAC) properties to be designated as HUBZones.

Conclusion

As leaders in innovation, net new job creation, and business formation, small businesses continue to be the economic backbone of the nation. As leaders, small businesses provide the best value for the taxpayer's dollar through an acquisition process characterized by competition. Small businesses are eager to compete for a share of the marketplace. The federal government's awarding of more than $130 billion to small businesses in FY 2006 is an indicator that, with a level playing field, small businesses will win their share of the federal acquisition dollar.

Table 3.7 Annual Change in the Dollar Volume of Contracts over $25,000 Awarded to Small, Women-Owned, and Minority-Owned Businesses, FY 1980 – FY 2003 and in Total, FY 2005-FY 2006* (thousands of dollars)

	Total, all business			Small business		
		Change from prior year			Change from prior year	
	Total (thousands of dollars)	Thousands of dollars	Percent	Total (thousands of dollars)	Thousands of dollars	Percent
2006*	340,212,001	19,902,759	8.3	77,670,193	2,670,193	.03
2005*	320,309,252	20,423,154	4.7	75,000,000	11,396,111	16.7
2004*	299,886,098	—	—	68,228,772	—	—
2003	292,319,145	47,740,664	19.5	59,813,330	12,587,280	26.7
2002	244,578,481	21,476,465	9,6	47,226,050	461,545	9.9
2001	223,338,280	17,490,979	8.5	46,764,505	7,983,057	20.6
2000	205,847,301	20,722,610	11.2	38,781,448	3,036,256	8.5
1999	185,124,691	1,013,686	0.6	35,745,192	1,485,753	4.3
1998	184,111,005	5,186,111	2.8	34,259,439	-7,013,742	-17.0
1997	178,924,894	-4,558-799	-2.5	41,273,181	8,082,760	24.4
1996	183,483,693	-1,636,299	-0.9	33,190,421	1,383,158	4.3
1995	185,119,992	3,619,653	2.0	31,807,263	3,384,230	11.9
1994	181,500,339	-2,926,609	-1.6	28,423,033	475,592	1.7
1993	184,426,948	1,345,741	0.7	27,947,441	-282,308	-1.0
1992	183,081,207	-10,469,218	-5.4	28,229,749	-617,609	-2.1
1991	193,550,425	14.263,523	8.0	28,847,358	3,445,732	13.6
1990	179,286,902	6,674,713	3.8	25,401,626	1,685,455	7.1
1989	172,612,189	-3,931,853	-2.2	23,716,171	-1,955,147	-7.8
1988	176,544,042	-5,206,284	-2.9	25,671,318	-2,256,401	-8.1
1987	181,750,326	-1,931,063	-1.1	27,927,719	-852,373	-3.0
1986	183,681,389	-4,505,240	-2.4	28,780,092	2,077,397	7.8
1985	187,985,466	20,085,235	11.9	26,702,695	1,196,672	4.7
1984	167,933,486	12,513,288	8,0	25,506,023	3,425,999	15.5
1983	155,588,106	3,190,222	2.1	22,080,024	-1,478,539	-6.3
1982	152,397,884	23,533,140	18.3	23,558,563	3,489,774	17.4
1981	128,864,744	27,971,359	27.7	20,068,789	4,742,668	30.9
1980	100,893,385	-	-	15,326,121	-	-

— Less than 0.05 percent.
* For FY 2004 and subsequent years, the new FPDS-NG data reflect all contract actions available for small business competition (excluding some categories), not just those over $25,000. The figures and are not strictly comparable with those shown for previous years; therefore, the FY 2003–FY 2004 change is not shown.
Source: Federal Procurement Data System, “Special Report S89522C” (prepared for the U.S. Small Business Administration, Office of Advocacy, June 12, 1989); and idem., Federal Procurement Report (Washington, D.C.: U.S. Government Printing Office, July 10, 1990, March 13, 1991, February 3, 1994, January 13, 1997, 1998, 1999, 2000), Eagle Eye Publishers, and Federal Procurement Data System, FPDS-NG.

Table 3.7 Annual Change in the Dollar Volume of Contracts over $25,000 Awarded to Small, Women-Owned, and Minority-Owned Businesses, FY 1980 – FY 2003 and in Total, FY 2005-FY 2006* (thousands of dollars) —continued

Women-owned business			Minority-owned business		
	Change from prior year			Change from prior year	
Total (thousands of dollars)	Thousands of dollars	Percent	Total (thousands of dollars)	Thousands of dollars	Percent
11,616,080	1,428,610	1.40	22,990,411	2,007,843	9.6
10,187,470	1,402,383	15.4	20,982,568	3,177,081	17.1
9,091,919	—	—	18,538,012	—	—
8,212,453	1,534,833	23.0	18,903,087	3,595,020	23.5
6,677,620	-3,595	—	15,308,067	754,369	5.2
6,681,215	2,226,212	50.0	14,553.698	1,966,900	15.6
4,455,003	427,264	10.6	12,586,798	727,575	5.8
4,027,739	485,838	13.7	11,859,223	414,203	3.6
3,541,901	-48,406	-1.3	11,445,020	312,398	2.8
3,590,307	621,845	20.9	11,132,622	491,851	4.6
2,968,462	148,214	5.3	10,640,771	121,302	1.2
2,820,248	508,700	22.0	10,519,469	1,459,981	16.1
2,311,548	262,828	12.8	9,059,488	255,468	2.9
2,048,720	56,155	2.8	8,804,020	1,007,913	12.9
1,992,565	227,399	12.9	7,796,107	1,309,818	20.2
1,765,166	287,272	19.4	6,486,289	796,229	14.0
1,477,894	74,955	5.3	5,690,060	356,172	6.7
1,402,939	75,215	5.7	5,333,888	141,382	2.7
1,327,724	74,839	6.0	5,192,506	343,381	7.1
1,252,885	56,034	4.7	4,849,125	563,200	13.1
1,196,851	102,643	9.4	4,285,925	401,286	10.3
1,094,208	238,077	27.8	3,884,639	-119,500	-3.0
856,131	244,755	40.0	4,004,139	817,048	25.6
611,376	60,775	11.0	3,187,091	328,180	11.5
550,601	-534,772	-49.3	2,858,911	223,903	8.5
1,085,373	297,844	37.8	2,635,008	813,087	44.6
787,529	-	-	1,821,921	-	-

Table 3.8 Contract Actions Over $25,000, FY 1984-FY 2003, and FY 2006 Total* with Annual 8(a) Set-Aside Breakout

	Thousands of dollars		
Fiscal year	Total	8(a) set-aside	8(a) share (percent)
2006*	340,212,001	12,478,606	3.7
2005*	320,309,252	11,790,162	3.7
2004*	299,886,098	8,438,046	2.8
2003	292,319,145	10,043,219	3.4
2002	258,125,273	7,868,727	3.0
2001	248,985,613	6,339,607	2.5
2000	207,537,686	5,785,276	2.8
1999	188,865,248	6,125,439	3.2
1998	184,176,554	6,527,210	3.5
1997	179,227,203	6,510,442	3.6
1996	183,489,567	6,764,912	3.7
1995	185,119,992	6,911,080	3.7
1994	181,500,339	5,977,455	3.3
1993	184,426,948	5,483,544	3.0
1992	183,081,207	5,205,080	2.8
1991	193,550,425	4,147,148	2.1
1990	179,286,902	3,743,970	2.1
1989	172,612,189	3,449,860	2.0
1988	176,544,042	3,528,790	2.0
1987	181,750,326	3,341,841	1.8
1986	183,681,389	2,935,633	1.6
1985	188,186,629	2,669,174	1.4
1984	168,101,394	2,517,738	1.5

*For FY 2004-FY 2006, the new FPDS-NG data shown here reflect all contract actions available for small business competition (excluding some categories), not just those over $25,000. The figures are not strictly comparable with those shown for previous years.
Source: General Services Administration, Federal Procurement Data System.

4 Minorities *in* Business: A Demographic Review *of* Minority Business Ownership

Synopsis

This report is the latest in the Office of Advocacy's series of periodic studies on minorities in business. The number and receipts of businesses owned by minorities have increased in the past several years, and they continue to make important contributions to the American economy.

This study follows the *Women in Business* study, released in 2006, the first of the two Office of Advocacy studies on small business subgroups. These reports provide basic information on important trends in America's small business economy and point users to key data sources in the U.S. government for more information.

Introduction

The total U.S. population consisted of 68.2 percent non-Hispanic Whites and 31.8 percent minorities in 2002 (Figure 4.1). When population proportions are linked to business ownership for minorities, Blacks were 11.8 percent of the total population, owned 5.0 percent of firms, and accounted for 0.99 percent of total receipts (Figures 4.1, 4.3, and 4.4). Hispanics were 13.5 percent of the total population, owned 6.55 percent of businesses and accounted for 2.48 percent of total receipts. Asians and Pacific Islanders represented about 4.1 percent of the total population, owned 4.72 percent of businesses, and accounted for 3.7 percent of total receipts.

On average, a White-owned employer firm had total sales or receipts 36 times that of a White-owned nonemployer firm in 2002 (Figure 4.5). The average number for Hispanics was 29; for Blacks, 34; Native Americans, 32; Asians, 20; and Islanders, 31. Nonemployer firms are small in business size but pervasive in firm number. On average, for every dollar a White-owned firm made, Pacific Islander-owned firms made about 59 cents; Hispanic-,

Figure 4.1 Racial/Ethnic Composition of Total U.S. Population, 2002

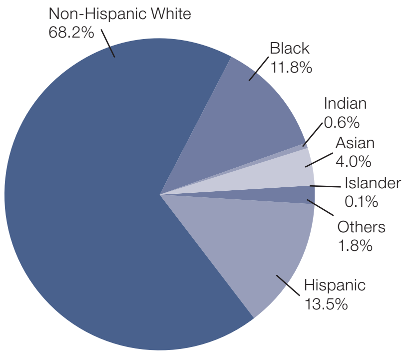
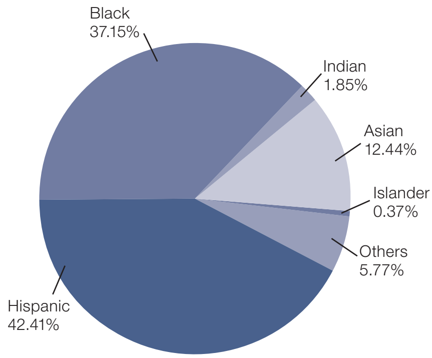


Figure 4.2 Racial/Ethnic Composition of U.S. Minority Population, 2002



Note: Hispanic can be of any race.
Data Source: Table 4.17. U.S. Census Bureau, American Community Survey, 2002.

Figure 4.3 Racial/Ethnic Composition of Business Firms without Publicly Held Companies, 2002

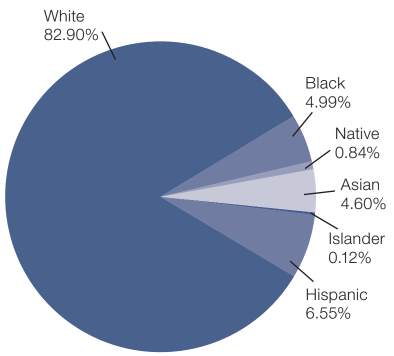
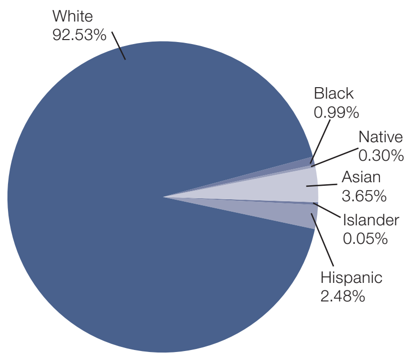


Figure 4.4 Racial/Ethnic Composition of Business Receipts without Publicly Held Companies, 2002

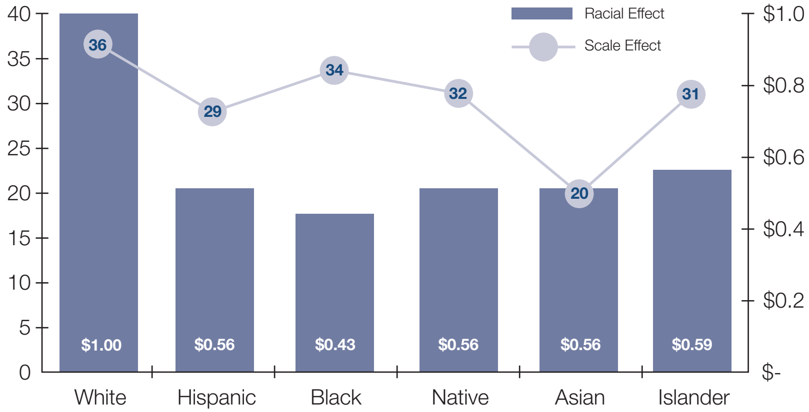


Notes: White includes Hispanic White. Hispanic may be of any race. Percentages here were calculated based on the sums of the number and business receipts of each group's firms. This permits multiple counts (for example, a business owner may be counted as both Hispanic and Black).
Data Source: Table 4.3 and Table 4A.1 in the Appendix.

Native American-, and Asian-owned businesses made 56 cents; and Black-owned firms made 43 cents (Figure 4.5).

In terms of legal form of organization, 2.02 percent of U.S. firms were publicly held in 2002 (Figure 4.6), and accounted for 60.70 percent of total business receipts in the same year (Figure 4.7). The share of minority-owned business receipts was less than 3 percent. Table 4.2 provides additional statistics relating to the economic circumstances of minorities.

Figure 4.5 Racial Effect and Scale Effect of Business Earnings, 2002



Note: In the comparison of minority-owned and nonminority-owned firms, two observable effects related to differences in their receipts are business size (the scale effect) and minority ownership (the racial effect). The scale effect is a ratio of employer to nonemployer receipts within each racial or ethnic catagory.
Data Source: Table 4.3 and Table 4A.1.

Figure 4.6 Racial/Ethnic Composition of Business Firms with Publicly Held Companies, 2002

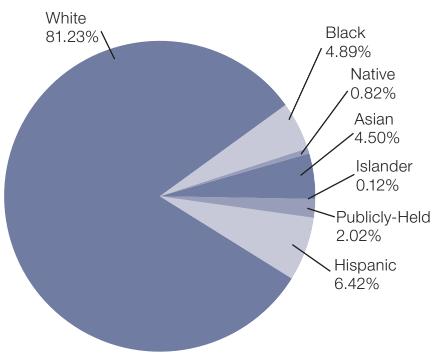
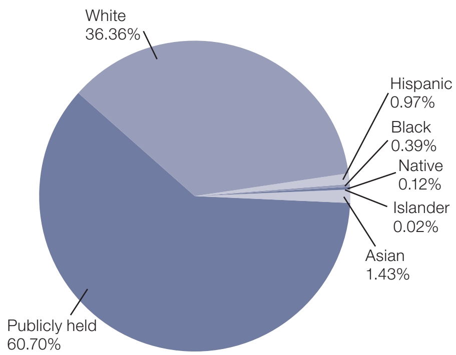


Figure 4.7 Racial/Ethnic Composition of Business Receipts with Publicly Held Companies, 2002



Notes: White includes Hispanic White. Hispanic may be of any race. Percentages here were calculated based on the sums of the number and business receipts of each group's firms. This permits multiple counts (for example, a business owner may be counted as both Hispanic and Black).
Data Source: Table 4.3 and Table 4A.1 in the Appendix.

Unless otherwise stated, all data used in this report were selected from datasets compiled by the U.S. Census Bureau. Discussions may be related to the gender of the owner or owners of a business (male, female, or equally male/female). Ethnicity refers to whether or not the owner is of Hispanic or Latino origin. Race is categorized as White, Black, American Indian or Alaska Native, Asian, and Native Hawaiian or other Pacific Islander. For

Table 4.1 A Snapshot of Minority Groups: Composition of the U.S. Minority Population and of the Number and Receipts of Firms, 2002 (percent)

	Composition of Minority Population, 2002	Composition of Minority Firm Number, 2002	Composition of Minority Firm Receipts, 2002
Hispanic	42.4	38.3	33.2
Black	37.2	29.2	13.3
Native American	1.9	4.9	4.0
Asian	12.4	26.9	48.9
Islander	0.4	0.7	0.6

Notes: Population data in this table were calculated without counting people who reported two races or more; however, Hispanics may be of any race. Population total does not sum to 100 because an "other" category (5.8 percent) is not displayed here. Business percentages here were calculated based on the sum of firm number and business receipts of each group that permits multiple counts (for instance, a business owner may be counted as both Hispanic and Black).

Population data source: U.S. Census Bureau, American Community Survey, 2002. Business data source: Table 4A.1.

Table 4.2 Household Income Distribution, Average Income, Poverty, and Health Insurance Noncoverage, 2005 (percent except as noted)

	Under $5,000	$100,000 or more	Median income (dollars) [1]	Poverty rate of all households[2]	Poverty rate of female householders[3]	No health insurance coverage[4]
Non-Hispanic White	2.5	19.7	50,784	6.0	22.6	11.3
Black	6.8	7.8	30,858	23.8	39.3	19.6
Asian	4.3	27.5	61,094	8.9	17.8	17.9
Hispanic	3.9	8.8	35,967	20.6	39.0	32.7

[1] Income in 2005 CPI-U-RS adjusted dollars. CPI-U-RS refers to the research series of the consumer price index. For more information, see http://www.bls.gov/cpi/cpiurstx.htm.
[2] Rate of all families in poverty.
[3] Rate of families with female householder and no husband present.
[4] Percentage of people not covered by any health insurance.
Data source: U.S. Census Bureau, Current Population Reports: Income, Poverty, and Health Insurance Coverage in the United States: 2005, http://www.census.gov/prod/2006pubs/p60-231.pdf.

simplicity, this study refers to the six large business groups as Hispanic, White, Black, Native American (American Indian or Alaska Native), Asian, and Islander (Native Hawaiian or other Pacific Islander).

The Native Hawaiian- and Other Pacific Islander-owned Firms report is new for 2002. Previously, estimates for this group of business owners were included in the Asian- and Pacific Islander-owned Businesses report. No detailed estimates were included by subgroup. Particular care should be taken in comparing the estimates for Asian-owned firms and Native Hawaiian- and Pacific Islander-owned firms from 1997 to 2002. It is further worth emphasizing that detail may not add to totals because Hispanics or Latinos may be of any race and each owner also had the option of selecting more than one race. Thus, a business may be double counted—included in more than one racial group, as well as the Hispanic ethnicity.

Besides using all firm data, the report also examines data for respondent firms. About 80 percent of businesses returned the survey form, provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s), and indicated whether the firm was publicly held.[1] As with all firm data, detail of the respondent firms may not add to totals for the reasons cited above. These respondent firm data will be used to discuss some special characteristics of minority-owned businesses.[2]

In addition to the Census data from the Economic Survey and the Survey of Business Owners, tables were also constructed from the Current Population Survey, March Supplement, to further explore the demographic characteristics of business owners. The author looked into the total population and labor force by gender and race, and examined two groups—professionals and moonlighters—to capture certain entrepreneurial characteristics. The remainder of the report consists of the following. A discussion of the characteristics of minority-owned businesses is followed by a look into characteristics of minority business owners; a look at minority business density, and the conclusion of the report. Detailed tables are included in the appendices.

Characteristics of Minority-owned Businesses

Gender, Race, and Ethnicity of Minority-owned Businesses

Business ownership of U.S. firms can be depicted by group and legal form of organization (Table 4.3).[3] In 2002, Hispanics or Latinos constituted the largest minority business community and owned 6.6 percent of all U.S. firms identifiable by race or ethnicity of their ownership, 3.7 percent of these employer firms, and 7.4 percent of nonemployer firms. Blacks owned 5.0 percent of these U.S. firms, 1.8 percent of employer firms, and 5.9 percent

1 This 80 percent was used to create a universe of respondent firms and thus does not account for the other 20 percent, or nonrespondent firms.

2 Detailed information and data can be found at http://www.census.gov/csd/sbo/cbsummaryoffindings.htm and http://www.census.gov/csd/sbo/cbosummaryoffindings.htm.

3 Because of double counting in the 2002 Survey of Business Owners, the difficulty of estimating the share of each group has required an estimate of the total number of firms in each case.

Table 4.3 Business Ownership by Gender, Hispanic or Latino Origin, and Race, 2002

	All firms		Firms with paid employees		Firms with no paid employees	
Ownership Status	Number	Percent	Number	Percent	Number	Percent
All firms[1]	22,974,655	X	5,524,784	X	17,449,871	X
Female-owned	6,489,259	28.2	916,657	16.6	5,572,602	31.9
Male-owned	13,184,033	57.4	3,524,969	63.8	9,659,064	55.4
Equally owned[2]	2,693,360	11.7	717,961	13.0	1,975,399	11.3
Publicly held[3]	494,399	2.2	352,720	6.4	141,679	0.8
Total by race/ethnicity of owner[4]	24,004,792	100.0	5,353,838	100.0	18,650,953	100.0
Hispanic[5]	1,573,464	6.6	199,542	3.7	1,373,922	7.4
White	19,899,839	82.9	4,712,119	88.0	15,187,720	81.4
Black	1,197,567	5.0	94,518	1.8	1,103,049	5.9
Native American[6]	201,387	0.8	24,498	0.5	176,889	0.9
Asian	1,103,587	4.6	319,468	6.0	784,118	4.2
Islander[7]	28,948	0.1	3,693	0.1	25,255	0.1

X = Detail may not sum to 100 percent.
1 Includes firms with and without paid employees.
2 Equally male-/female-owned.
3 Publicly held and other firms whose owners' characteristics are indeterminate.
4 The total here is the sum of races and ethnicities claimed by business owners in the six major racial/ethnic categories. This total permits double counting of the number of businesses. Publicly held companies are not included in this total. The author used this denominator in estimating each minority business group's share of the total.
5 Hispanic or Latino can be of any race.
6 American Indian and Alaska Native.
7 Native Hawaiian and Other Pacific Islander.
Data source: Table 4A.1. Data from U.S. Census Bureau, 2002 Survey of Business Owners, http://www.census.gov/csd/sbo/chartable_a.xls.

of nonemployer firms. Asians and Islanders owned 4.7 percent of U.S. firms, 6.1 percent of employer firms, and 4.3 percent of nonemployer firms. For comparison purposes, the percentages for Whites are 82.9, 88.0, and 81.4 percent, respectively.

The gender distribution among business owners by race for employer firms and nonemployer firms shows that a higher percentage of minority women owned businesses in 2002 than in 1997 (Table 4.4). Women owned 29 percent of Black employer firms and 47 percent of Black nonemployer firms in 2002; women owned 17 percent of White employer firms and 31 percent of White nonemployer firms.

Table 4.4 Gender Distribution of Business Owners by Hispanic or Latino Origin and Race, 1997 and 2002

Ownership by gender, Hispanic or Latino origin, and race	2002 Survey of Business Owners				1997 Survey of Minority Business Enterprises			
	Employer firms		Nonemployer firms		Employer firms		Nonemployer firms	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
All U.S. firms	**5,524,784**	**100**	**17,449,871**	**100**	**5,295,151**	**NA**	**15,526,783**	**NA**
Female	916,657	17	5,572,602	32	846,780	16	4,570,254	29
Male	3,524,969	64	9,659,064	55	S	NA	S	NA
Equally owned	717,961	13	1,975,399	11	16,784	NA	32,809	NA
Publicly held	352,720	6	141,679	1	NA	NA	NA	NA
Hispanic	**199,542**	**100**	**1,373,922**	**100**	**211,884**	**100**	**988,012**	**100**
Female	43,142	22	497,603	36	39,108	18	298,600	30
Male	136,832	69	784,351	57	134,801	64	531,685	54
Equally owned	19,568	10	91,968	7	37,975	18	157,727	16
White	**4,712,119**	**100**	**15,187,720**	**100**	**4,372,817**	**100**	**12,943,980**	**100**
Female	815,304	17	4,764,858	31	719,290	16	3,768,299	29
Male	3,251,897	69	8,667,165	57	2,749,651	63	6,939,364	54
Equally owned	644,926	14	1,755,696	12	903,876	21	2,236,318	17
Black	**94,518**	**100**	**1,103,049**	**100**	**93,235**	**100**	**730,264**	**100**
Female	27,027	29	520,005	47	20,806	22	292,078	40
Male	58,054	61	513,447	47	60,411	65	383,233	52
Equally owned	9,437	10	69,597	6	12,019	13	54,953	8
Native American[1]	**24,498**	**99**	**176,889**	**100**	**33,277**	**100**	**164,023**	**100**
Female	7,372	30	70,920	40	8,739	26	44,854	27
Male	15,939	65	100,469	57	19,646	59	87,226	53
Equally owned	980	4	5,497	3	4,893	15	31,943	19

Table 4.4 Gender Distribution of Business Owners by Hispanic or Latino Origin and Race, 1997 and 2002 —continued

Ownership by gender, Hispanic or Latino origin, and race	2002 Survey of Business Owners				1997 Survey of Minority Business Enterprises			
	Employer firms		Nonemployer firms		Employer firms		Nonemployer firms	
	Number	Percent	Number	Percent	Number	Percent	Number	Percent
Asian	**319,468**	**100**	**784,119**	**100**	**286,976**	**100**	**606,614**	**100**
Female	71,177	22	268,377	34	57,162	20	185,039	31
Male	203,504	64	436,859	56	174,835	61	312,494	52
Equally owned	44,787	14	78,883	10	54,978	19	109,081	18
Islander	**3,693**	**—**	**25,255**	**—**	**3,023**	**100**	**16,347**	**100**
Female	837	23	9,745	39	647	21	5,117	31
Male	2,690	73	13,488	53	1,730	57	8,400	51
Equally owned[2]	—	—	—	—	646	21	2,831	17

S = Estimates are suppressed when publication standards are not met, for example, when the firm count is less than 3 or the relative standard error in sales and receipts is 50 percent or more.
NA = Not available.
[1] Some American Indian and Alaska Native employer firms may be owned by the federal government.
[2] Data were not available in the 2002 SBO dataset.
Data source: U.S. Census Bureau, 2002 Survey of Business Owners and 1997 Survey of Minority-owned Business Enterprises.

Number, Receipts, Employment, and Annual Payroll of Minority-owned Firms

Detailed information about U.S. business ownership by race for 1997 and 2002 reflects a variety of patterns in the number, receipts, employment, and payroll of these businesses (see Table 4A.1 in the Appendix). Of all minority-owned businesses in 2002, Hispanics owned nearly 1.6 million; Blacks, almost 1.2 million; and Asians, 1.1 million. Of employer firms, Hispanics owned 199,542; Blacks, 94,518; and Asians, 319,468.

To further evaluate the status of minority-owned businesses, the author created a data table that shows business performance and other characteristics (Table 4.5). In 2002, minorities owned approximately 18 percent of the 23 million U.S. firms.[4] Without counting publicly held firms, Asians had a ratio of employer to nonemployer firms of 29 percent; Hispanics, 13 percent; Whites, 24 percent; Blacks, 8 percent; Native Americans, 12 percent; and Islanders, 13 percent. Employer firms produced the majority of total receipts, from 74.2 percent for Blacks to 91.9 percent for Whites. Asians had the smallest average number of employees, 7. Black employers had the lowest average payroll per worker, $23,277, and the highest was paid by White employers at $29,666. On average, a White-owned employer firm had over $1.6 million in sales in 2002; a Black-owned employer firm, $696,158. Receipts for Asian nonemployer firms averaged $45,275; for Black nonemployer firms, $20,708. These numbers also can be seen in Figure 4.8.

The Sizes of Minority-owned Businesses

Sizes of businesses can be measured by receipts or number of employees. Of Black-owned firms, 50.8 percent made less than $10,000 in total business receipts in 2002, while 33.7 percent of White-owned firms and 28.8 percent of Asian-owned firms were in this category (Table 4.6). Five percent of White-owned firms and 4.5 percent of Asian-owned firms made $1 million or more in 2002, while fewer than 1 percent of Black-owned firms and fewer than 2 percent of Hispanic- and Native American-owned firms were in this category.

Most U.S. businesses have fewer than 10 employees (Table 4.7). In 2002, 80 percent of White-owned employer firms had fewer than 10 employees; these small firms accounted for 21 percent of total receipts. Of firms owned

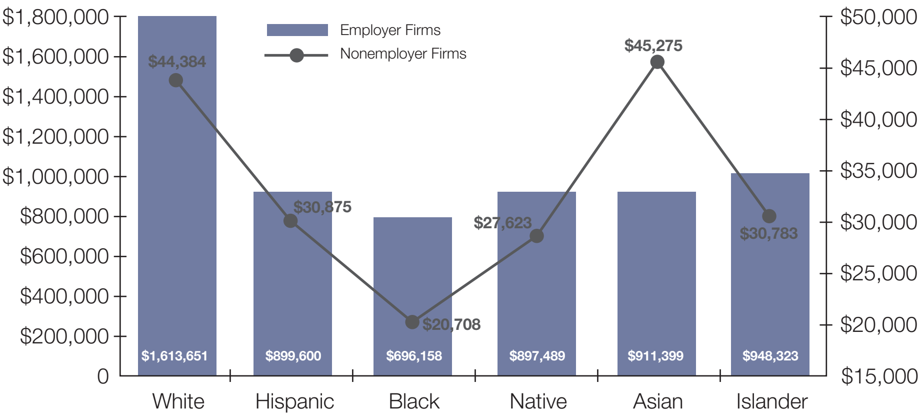
4 There is no U.S. Census official estimate of the total number of minority-owned businesses. The author estimated the minority-owned number by subtracting from the total number of U.S. firms the total number of publicly owned and White-owned firms, and adding the number of Hispanic-owned firms.

Table 4.5 Business Performance by Hispanic or Latino Origin and Race of Owner, 2002

	Employer firm ratio (percent)[1]	Employer receipts ratio (percent)[2]	Employees per employer firm[3]	Average payroll per employee (dollars)[4]	Average receipts per nonemployer firm (dollars)	Average receipts per employer firm (dollars)
Hispanic	13	80.9	8	23,888	30,875	899,600
White	24	91.9	11	29,666	44,384	1,613,65
Black	8	74.2	8	23,277	20,708	696,158
Native American	12	81.8	8	26,848	27,623	897,489
Asian	29	89.1	7	25,314	45,275	911,399
Islander	13	81.8	8	28,180	30,783	948,323

[1] Ratio of total employer firms to total firms.
[2] Ratio of total employer firm receipts to total firm receipts.
[3] Number of employees divided by total number of employer firms.
[4] Total payroll divided by total number of employees.
Data source: Table 4A.1 and additional nonemployer data from U.S. Census Bureau, 2002 Survey of Business Owners.

Figure 4.8 Average Receipts per Employer Firm and Nonemployer Firm, 2002



Data Source: Tables 4.5 and 4A.1.

by Asians, 84 percent had fewer than 10 workers and these businesses accounted for 39 percent of total Asian-owned business receipts. (Note that publicly traded companies are not included in these figures.)

The number of firms with 500 or more employees is very small. Of White-owned employer firms, 0.14 percent were large in 2002, but they accounted for more than 18 percent of total White employer firm receipts. Asians had the smallest proportion of businesses—0.04 percent— with 500 or more employees, and these large firms accounted for less than 7 percent of Asian business receipts.

Table 4.6 Business Receipts Sizes by Race and Hispanic or Latino Origin, 2002 (percent)						
Annual receipts size of firm	Hispanic	White	Black	Native American	Asian	Islander
Less than $5,000	20.8	20.6	30.0	26.9	15.9	25.3
$5,000 to $9,999	19.1	13.1	20.8	18.1	12.9	21.3
$10,000 to $24,999	24.8	17.7	24.6	21.5	18.1	20.6
$25,000 to $49,999	12.1	12.1	10.5	12.0	12.6	10.1
$50,000 to $99,999	8.8	10.5	6.2	8.4	11.0	7.5
$100,000 to $249,999	7.1	10.9	4.3	6.6	12.8	7.7
$250,000 to $499,999	3.3	5.9	1.7	3.0	7.4	3.3
$500,000 to $999,999	2.1	4.2	1.0	1.7	4.7	1.7
$1,000,000 or more	1.9	5.0	0.9	1.8	4.5	2.5

Data source: U.S. Census Bureau, 2002 Survey of Business Owners: Company Summary, released September 14, 2006.

The Industry Divisions of Minority-owned Businesses

The distribution of firms varies by industry and race (Table 4.8). For example, 16 percent of Native American-owned firms operated in construction; 20.5 percent of Black-owned firms were in health care and social assistance. Hispanic- and Islander-owned businesses were concentrated in administrative and support, waste management, and remediation services, 13.2 percent and 11.6 percent, respectively. All minority-owned business categories had higher proportions than the non-minority-owned businesses in "other services," such as personal services and repair and maintenance. Of Black-owned firms, 17.6 percent were in other services, for Asians, the share was 17.1 percent; for Hispanics, 15.8 percent; and for Native Americans, 13.2 percent.

About one-third—32 percent—of women-owned firms overall are also in services.[5] Women owned 72 percent of social assistance businesses and just over half of nursing and residential care facilities.

Of Black women-owned firms, 35 percent were in health care and social assistance, compared with 26 percent of firms owned by Native Hawaiian and other Pacific Islander women, 23 percent of those owned by Hispanic women, and 22 percent of American Indian and Alaska Native women-owned firms.

Table 4.9 exhibits the sectors and receipts amounts of the top seven largest business sectors for Hispanic- and Black-owned firms. Hispanic-owned firms had more than $40 billion in receipts from retail trade, while

5 See http://www.census.gov/csd/sbo/companysummaryoffindings.htm.

Table 4.7 Distribution of the Number and Receipts of Minority-owned Employer Businesses by Employment Size of Firm, 2002 (percent)

	Hispanic		White		Black		Native American		Asian		Islanders	
Size	Number	Receipts	Number	Receipts	Number	Receipts	Number	Receipts	Number	Receipts	Number	Receipts
Micro	84.10	34.33	79.76	21.48	85.10	32.58	84.13	30.97	84.42	38.95	80.40	28.70
Small	15.81	57.43	20.11	60.40	14.90	60.14	15.78	57.96	15.54	54.53	19.60	71.30
Large	0.09	8.24	0.14	18.13	0.10	7.28	0.09	11.06	0.04	6.52	0.00	0.00

Micro = Businesses with fewer than 10 employees.
Small = Businesses with more than 10 but fewer than 500 employees.
Large = Businesses with 500 or more employees.
Data source: Tables 4A.2 and 4A.3, based upon data from the U.S. Census Bureau, 2002 Survey of Business Owners: Company Summary, released September 14, 2006.

Table 4.8 Industry Divisions of All U.S. Firms by Race and Hispanic or Latino Origin, 2002 (percent)

Kind of business	All firms by Hispanic or Latino origin and race[1]					
	Hispanic-owned firms	White-owned firms	Black- owned firms	Native-owned firms	Asian- owned firms	Islander- owned firms
Total, all sectors	X	X	X	X	X	X
Agricultural support services[2]	0.6	1.1	0.3	2.3	0.6	1.9
Mining	0.1	0.5	0.0	0.5	0.0	0.4
Utilities	0.0	0.1	0.0	0.1	0.0	0.0
Construction	13.5	13.2	6.3	16.0	3.5	9.9
Manufacturing	2.0	2.6	0.8	3.0	2.1	1.1
Wholesale trade	2.2	3.1	1.0	2.1	4.2	1.3
Retail trade	9.6	11.4	8.5	10.2	13.7	12.4
Transportation and warehousing[3]	8.0	4.0	8.3	4.9	4.7	4.9
Information	0.9	1.3	1.2	1.3	1.1	1.1
Finance and insurance[4]	2.1	4.0	2.4	2.4	2.7	2.0
Real estate and rental and leasing	4.4	9.5	4.4	4.6	6.8	6.4
Professional, scientific, and technical services	8.8	14.9	9.7	11.2	14.0	11.2
Management of companies and enterprises	0.0	0.1	0.0	0.0	0.0	0.0
Administrative and support services[5]	13.2	6.8	10.1	7.8	4.8	11.6
Educational services	1.2	1.7	2.1	1.8	1.4	1.5
Health care and social assistance	11.5	7.8	20.5	12.1	11.2	S

Table 4.8 Industry Divisions of All U.S. Firms by Race and Hispanic or Latino Origin, 2002 (percent) —continued

Kind of business	All firms by Hispanic or Latino origin and race[1]					
	Hispanic-owned firms	White-owned firms	Black- owned firms	Native-owned firms	Asian- owned firms	Islander- owned firms
Arts, entertainment, and recreation	2.8	4.3	4.5	4.6	2.4	5.8
Accommodation and food services	3.1	2.6	2.1	1.8	9.5	1.8
Other services (except public administration)[6]	15.8	11.2	17.6	13.2	17.1	S
Industries not classified	0.1	0.1	0.1	0.1	0.1	S

X = Detail may not add to 100 percent because firms with more than one domestic establishment are counted in each industry in which they operate, but only once in the U.S. total.
S = Estimates are suppressed when publication standards are not met, for example, when the firm count is less than 3 or the relative standard error in sales and receipts is 50 percent or more.
[1]All firms include firms with and without paid employees.
[2] Including forestry, fishing and hunting, and agricultural support services representing North American Industry Classification System (NAICS) code 113-115. Data do not include crop and animal production (NAICS 111, 112).
[3]Data do not include large certificated passenger carriers that report to the Office of Airline Information, U.S. Department of Transportation. Railroad transportation and the U.S. Postal Service are out of scope for the 2002 Economic Census.
[4]Data do not include funds, trusts, and other financial vehicles (NAICS 525), except real estate investment trusts (NAICS 525930).
[5]Includes administrative and support and waste management and remediation services.
[6]Includes services such as personal services, repair and maintenance, and does not include religious, grantmaking, civic, professional, and similar organizations (NAICS 813) and private households (NAICS 814).
Data source: U.S. Census Bureau, 2002 Survey of Business Owners: Company Summary released September 14, 2006.

Blacks had nearly $14 billion in 2002. The second largest receipts category for Black-owned firms was health care and social assistance, accounting for almost $12 billion; the second largest for Hispanic-owned firms was in wholesale trade, with more than $39 billion.

Ethnicity of Asian- and Hispanic-owned Firms

In 2002, 1.1 million Asian-owned nonfarm businesses in the United States employed more than 2.2 million people and generated almost $327 billion in revenues (Table 4A.1). Asian-owned firms accounted for 4.8 percent of all nonfarm businesses in the United States, 2.0 percent of their employment, and 1.4 percent of their receipts. The ethnicities of Asian business owners were identified as Asian Indian, Chinese, Filipino, Japanese, Korean, Vietnamese, and Other Asian.[6]

Business performance characteristics for Asian-owned firms in 2002 varied by ethnic group (Table 4.10). Among this group, Asian Indians had the highest ratio of firms with employees to total firms, 37 percent, followed by Koreans (36 percent) and Chinese (31 percent). Asian Indians also had the highest average receipts per nonemployer firm, $56,792, followed by Koreans, $56,320. Japanese had the highest receipts per employer firm, $1,256,646, followed by Chinese, $1,075,029. Asian Indians once again had the highest average annual payroll per employee, $28,779, followed by Japanese at $28,141.

The ethnicities of Hispanic business owners were identified as Mexican, Mexican American, and Chicano; Puerto Rican; Cuban; and other Spanish/Hispanic/Latino (Table 4.11). Among this group in 2002, Cubans had the highest employer firm to total firm ratio, 18 percent; the highest average receipts per nonemployer firm, $36,692; the highest receipts per employer firm, $1,108,998; and the highest average annual payroll per employee, $28,769. Mexicans, Mexican Americans, and Chicanos had the highest average employee number per employer firm, 8.1, followed by other Spanish/Hispanic/Latino, 7.5.

Home-based Businesses

Approximately half of the 16.7 million SBO respondent firms, including employers and nonemployers, were home-based in 2002 (Table 4.12). Firms

6 The 2002 Survey of Business Owners (SBO) defines Asian-owned businesses as firms in which Asians own 51 percent or more of the stock or equity of the business. The data were collected as part of the 2002 Economic Census from a large sample of all nonfarm businesses filing 2002 tax forms as individual proprietorships, partnerships, or any type of corporation, and with receipts of $1,000 or more.

Table 4.9 Industries Accounting for the Most Receipts of Hispanic- and Black-owned Firms, 2002 (receipts in millions of dollars)		
Sector	Hispanic	Black
Retail trade	40,424	13,587
Wholesale trade	39,323	5,604
Construction	31,446	9,632
Manufacturing	17,965	4,647
Health care and social assistance	13,758	11,828
Professional, scientific, and technical services	15,017	9,395
Administrative and support and waste management	12,206	6,416

Note: Receipts are for firms with and without paid employees.

Data source: U.S. Census Bureau 2002 Survey of Business Owners, Hispanic-owned Firms, revised August 29, 2006, http://www.census.gov/csd/sbo/hispanic2002.htm, and Black-owned Firms, http://www.census.gov/csd/sbo/black2002.htm.

Table 4.10 Business Performance of Asian-owned Firms by Ethnicity, 2002					
	Employer ratio (percent)	Receipts per nonemployer (dollars)	Receipts per employer (dollars)	Employees per employer	Annual payroll per employee (dollars)
Asian total	29	45,275	911,399	6.9	25,314
Asian Indian	37	56,792	972,221	7.4	28,779
Chinese	31	47,319	1,075,029	7.3	23,525
Filipino	16	30,423	550,729	6.6	27,183
Japanese	26	42,758	1,256,646	9.3	28,141
Korean	36	56,320	723,473	5.6	20,906
Vietnamese	17	32,768	450,665	4.9	22,346
Other Asian	28	39,596	874,989	6.5	23,593

Data source: Table 4A.4, based on U.S. Census Bureau, 2002 Survey of Business Owners, Asian-owned Firms, revised August 29, 2006, http://www.census.gov/csd/sbo/asian2002.htm.

Table 4.11 Business Performance of Hispanic-owned Firms by Ethnicity, 2002					
	Employer ratio (percent)	Receipts per nonemployer (dollars)	Receipts per employer (dollars)	Employees per employer	Annual payroll per employee (dollars)
Hispanic or Latino total	13	30,875	899,600	7.7	23,888
Mexican, Mexican American, or Chicano	13	31,655	866,537	8.1	22,088
Puerto Rican	11	28,282	809,702	6.5	27,335
Cuban	18	36,692	1,108,998	7.4	28,769
Other Spanish, Hispanic, or Latino	11	28,530	878,299	7.5	23,971

Data source: Table 4A.5, based on U.S. Census Bureau, 2002 Survey of Business Owners, Hispanic-owned Firms, revised August 29, 2006, http://www.census.gov/csd/sbo/hispanic2002.htm.

Table 4.12 Home-based Respondent Firms by Employment Size and by Race, Ethnicity, and Gender, 2002 (percent)

	Percent of employer respondent firms										
Employment size	All	Hisp.	White	Black	Native Amer.	Asian	Island	Female	Male	Equal	Public
All firms	49.4	44.9	51.5	53.1	55.5	28.2	53.2	56.1	47.1	54.0	13.0
Nonemployers	58.3	49.1	60.0	56.2	59.6	35.5	58.0	61.4	56.3	63.2	16.8
Employers	22.1	22.4	23.8	25.0	29.2	10.5	24.2	23.7	22.0	27.5	11.4
No employees	41.5	37.2	44.5	37.8	47.6	18.9	21.7	39.5	43.1	44.9	27.1
1 to 4	29.3	24.9	31.1	28.1	33.0	12.5	35.9	28.5	29.1	36.1	19.7
5 to 9	11.0	13.5	11.8	15.2	14.9	3.6	13.8	10.3	11.0	14.5	6.4
10 to 19	6.0	10.6	6.4	12.3	11.4	3.1	13.0	7.1	5.7	8.3	2.9
20 to 49	2.7	7.0	2.9	7.3	3.7	2.1	6.1	4.8	2.3	4.9	1.4
50 to 99	1.6	4.7	1.8	4.1	S	S	0.0	3.0	1.6	2.5	0.7
100 to 499	0.7	1.7	1.0	0.9	2.6	1.0	0.0	1.6	0.8	2.4	S
500 or more	0.2	5.6	0.4	0.0	0.0	0.0	0.0	1.7	0.2	S	0.0

Abbreviations: Hisp.=Hispanic-owned firms; Native Amer. = Native American-owned firms; Island=Islander-owned firms; Equal=Female/male equally owned firms; and Public=publicly held firms.
S = Estimates are suppressed when publication standards are not met, for example, when the firm count is less than 3 or the relative standard error of sales and receipts is 50 percent or more.
Notes: The employer data include firms with and without paid employees. Some employer firms with seasonal employment or no employment at times when employment is measured will appear as having no employees. A respondent firm is defined as a business that returned the survey form, and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Publicly held includes other firms whose owners' characteristics are indeterminate.

Data source: U.S. Census Bureau, See http://www.census.gov/csd/sbo/cbsummaryoffindings.htm

owned by women respondents (56.1 percent) and by respondents representing equally male- and female-owned firms (54.0 percent) were more likely to be home-based than those owned by male respondents (47.1 percent). Fifty-six percent of Native American-owned firms, 53 percent of both Black- and Native Hawaiian and other Pacific Islander-owned firms, and 45 percent of Hispanic-owned firms reported that they were home-based.

Of nonemployers, 58.3 percent were home-based, compared with 22.1 percent of employers. Home-based business rates decline sharply with firm employment size. Twenty-nine percent of all respondent employer firms with 1 to 4 employees were home-based, as were 0.2 percent of those with 500 or more employees.

Home-based rates varied by ethnic and racial characteristic, a fact that may also be related to the industries in which these firms are concentrated. More than two-thirds of Asian business owners reported that they conducted business from nonresidential locations. Hispanics had a relatively smaller share of firms with one to four employees that were home-based, but a relatively large share—5.6 percent—of large firms were based in the home.

According to the Survey of Business Owners, four industries accounted for the largest share of home-based businesses: professional, scientific, and technical services (19 percent); construction (16 percent); retail trade (11 percent); and other services, such as personal services or repair and maintenance (10 percent).[7] Nearly 65 percent of businesses with receipts of less than $5,000 were home-based, compared with only 5.8 percent of firms with receipts of $1 million or more.

Minority-owned Firm Finance

More than 50 percent of all owners of respondent firms reported that their business was their primary source of income in 2002—70 percent of the owners of employer respondent firms and 44 percent of the owners of nonemployer firms.

Owners use a variety of sources of capital to start or acquire businesses (Tables 4.13 and 4.14). Nonemployer firm owners generally use a less varied array of financing sources than owners of firms with employees. Among minority employers, 74.8 percent of Asians used personal or family savings to finance business startups or acquisitions, compared with 71.0 percent of Hispanics, 67.1 percent of Whites, 69.0 percent of Blacks, 67.2 percent of Native Americans, and 62.1 percent of Islanders.

Higher percentages of male/female equally owned, male-owned and White-owned employer firms financed their startups or acquisitions through business loans from banks. Higher percentages of Black- and Native American-owned employer businesses, as well as equally men- and women-owned employer firms used business loans from the government or government-guaranteed bank loans. More than all other groups, Islander employers used personal and business credit cards to finance their startups and acquisitions.

The Growth of Minority-owned Business

According to the 2002 SBO, one-fifth of employer respondent firms and nearly 17 percent of nonemployer respondent firms reported that their business was established, purchased, or acquired between 1990 and 1996. In

7 See http://www.census.gov/csd/sbo/cbsummaryoffindings.htm.

Table 4.13 Sources of Capital Used to Start or Acquire Employer Firms by Hispanic or Latino Origin, Race, and Gender of Owner, 2002 (percent of employer respondent firms)

	Personal/ family savings	Other personal/ family assets	Personal/ business credit card	Business loan from government	Government-guaranteed bank loan	Business loan from bank	Outside investor	None needed	Item not reported
All respondent firms	64.2	13.1	9.2	1.7	1.7	22.2	4.7	11.8	3.7
Hispanic	71.0	12.7	12.8	1.8	1.5	14.8	3.3	8.7	3.2
White	67.1	13.8	9.5	1.6	1.7	23.1	4.1	10.3	2.6
Black	69.0	13.1	15.0	2.9	2.7	17.6	3.7	9.3	4.0
Native American	67.2	17.1	15.0	2.6	2.8	20.0	4.4	9.9	2.5
Asian	74.8	13.3	10.4	1.7	2.0	20.1	4.4	5.8	2.8
Islander	62.1	22.7	20.6	S	S	17.3	3.3	9.4	3.8
Female	67.5	14.5	11.9	1.9	2.0	19.5	3.8	10.6	2.6
Male	66.6	12.6	8.7	1.4	1.5	23.1	4.2	10.7	2.9
Equally owned	72.1	18.5	11.6	2.2	2.7	25.6	4.0	5.8	1.7
Publicly held	26.9	6.1	3.3	2.6	1.2	15.0	11.4	31.5	15.8

S = Estimates are suppressed when publication standards are not met, for example, when the firm count is less than 3 or the relative standard error in sales and receipts is 50 percent or more.

Data source: U.S. Census Bureau, 2002 Survey of Business Owners, Characteristics of Businesses, released September 27, 2006.

Table 4.14 Sources of Capital Used to Start or Acquire Nonemployer Firms by Hispanic or Latino Origin, Race, and Gender, 2002 (percent of employer respondent firms)

	Personal/ family savings	Other personal/ family assets	Personal/ business credit card	Business loan from government	Government-guaranteed bank loan	Business loan from bank	Outside investor	None needed	Item not reported
All respondent firms	51.5	7.7	8.6	0.7	0.4	7.9	2.0	32.9	4.0
Hispanic	47.5	5.6	8.8	0.6	0.2	3.9	1.6	37.6	5.4
White	51.7	7.7	8.6	0.6	0.4	8.1	1.9	33.2	3.5
Black	48.1	6.4	9.5	0.9	0.3	4.4	2.0	35.6	6.8
Native American	49.5	8.8	11.7	0.7	0.5	5.9	1.7	34.1	5.3
Asian	56.0	7.1	9.2	0.7	0.3	6.1	2.5	29.5	4.0
Islander	51.0	8.3	11.4	S	S	3.2	1.9	33.2	3.3
Female	45.1	5.8	8.8	0.5	0.2	3.5	1.2	41.6	4.4
Male	52.3	7.4	8.1	0.6	0.4	8.8	2.2	32.1	3.7
Equally owned	66.9	14.0	11.3	1.2	0.8	14.8	2.5	14.6	1.5
Publicly held	25.6	8.2	1.6	2.4	1.0	11.4	12.8	17.8	32.0

S = Estimates are suppressed when publication standards are not met, for example, when the firm count is less than 3 or the relative standard error in sales and receipts is 50 percent or more.
Data source: U.S. Census Bureau, 2002 Survey of Business Owners Characteristics of Businesses, released September 27, 2006.

Table 4.15 Change in the Number, Receipts, Employment, and Payroll of Minority-owned Firms, 1997 to 2002[1] (percent)

Business Group	Number of firms	Receipts[2]	Number of employer firms	Employer receipts[2]	Number of employees	Annual payroll[2]
All	10.3	21.8	4.3	21.9	7.2	29.8
Hispanic	31.1	19.1	-5.8	13.1	10.7	23.1
Non-Hispanic White[3]	7.5	4.3	4.0	2.8	-6.2	8.3
Black	45.4	24.5	1.4	16.7	5.0	22.5
Native American[4]	2.1	-21.8	-26.4	-24.8	-36.0	-22.5
Asian[5]	26.7	9.3	12.6	7.3	3.4	25.3
Publicly held	29.6	36.0	—	36.5	24.6	52.1

— Data are not available.
[1] Because of differences in questionnaires, the 2002 SBO and 1997 SMOBE are not directly comparable. Readers should be cautious when using the percentage change data. For detail about the differences between the 1997 and 2002 surveys, see Appendix 4B and http://www.census.gov/econ/census02/text/sbo/sbomethodology.htm.
[2] Growth rates for receipts and payroll are calculated in current rather than constant values.
[3] Because 2002 non-Hispanic White-owned business data are not available, the author estimates the 2002 figure by subtracting Hispanic-owned businesses from White-owned businesses. This result may underestimate White-owned businesses in 2002.
[4] Significant comparability issues may exist in data for Native American-owned businesses between 1997 and 2002. See the appendix for detail.
[5] Asian as used here includes Native Hawaiian and Other Pacific Islander for comparability with 1997 data.
Data sources: U.S. Census Bureau, 2002 Survey of Business Owners and 1997 Survey of Minority-owned Business Enterprises.

2002, 17.3 percent of all firms reported that their business was started within the previous two years.

The surveys of minority-owned businesses are not directly comparable between 1997 and 2002.[8] Using the U.S. Census Bureau published data, Table 4.15 provides a proxy for minority business growth between 1997 and 2002. Without counting publicly held firms, Black-owned firms had the highest growth rate for several measures between 1997 and 2002: 45.4 percent in the number of firms, 24.5 percent in total receipts, and 16.7 percent in employer firm receipts. Asians also experienced growth in the number of employer firms, 12.6 percent, and in annual payroll, 25.3 percent. American Indians and Native Alaskans saw slower business growth and declines in some measures. Their business number increased by 2.1 percent.

Growth rates in average receipts for three large business groups—Hispanic, White, and Black—were all in positive territory. Hispanic-owned

8 The data comparability is described in the Appendix; or at the U.S. Census Bureau's website: http://www.census.gov/econ/census02/text/sbo/sbomethodology.htm.

employer firms' receipts grew 20 percent and corresponding nonemployer receipts 11 percent between 1997 and 2002.[9]

Table 4.16 estimates the quinquennial growth in the numbers of the six large business groups identified by race and Hispanic ethnicity between 1982 and 2002. This table indicates rapid growth in the number of Hispanic-, Black-, and Islander-owned businesses between 1997 and 2002. The growth in Native American-owned businesses was positive for 10 years between 1987 and 1997, but slowed significantly between 1997 and 2002.

Demographic Characteristics of Minority Business Owners

For a better understanding of minority-owned businesses in the United States, it is useful to look at the demographics of their owners—including information about education, age, labor force characteristics, and self-employment characteristics, as well as the characteristics of professionals and of moonlighters working more than one job.[10]

In the U.S. population overall, 45 percent of U.S. employer business owners and 38 percent of nonemployers had completed college or higher education as of 2002 (Figure 4.9). Of the owners of respondent firms, 31 percent were over the age of 55, 20 percent were between the ages of 55 and 64, and 11 percent were over the age of 65.[11] In addition, 29 percent of all owners of respondent firms were between 45 and 54 years old; 24 percent were between 35 and 44 years old; 12 percent were between 25 and 34 years old; and only 2 percent were under 25 years old. Young people were more likely to own nonemployer businesses: 93 percent of those under 25 reported that they owned businesses without employees.

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9 The growth rate for Asian- and Islander-owned firms seemed to be erratic, partly because of changes in racial categorizations. Asians and Islanders were in one group for the 1997 survey but were separated into two groups for the 2002 survey.

10 Data presented in this section are primarily from the 2002 American Community Survey (ACS) and the 2005 Current Population Survey (CPS) using 2004 data. Professionals include "Management, business, and financial occupations" and "Professional and related occupations" as classified in the U.S. Census's Current Population Survey March Supplement.

11 U.S. Census Bureau, 2002 Survey of Business Owners, Characteristics of Business Owners, released September 27, 2006.

Table 4.16 Change in the Number of Minority-owned Firms, 1982-2002

	Number of businesses					Percentage change			
	1982	1987	1992	1997	2002	1982-1987	1987-1992	1992-1997	1997-2002
All	12,059,950	13,695,480	17,253,143	20,821,934	22,974,655	14	26	21	10
White[1]	11,234,999	12,419,170	15,103,959	17,316,796	18,609,599	11	22	15	6
Black	308,260	424,165	620,912	823,499	1,197,567	38	46	33	45
Hispanic	284,011	489,973	862,605	1,199,896	1,573,464	73	76	39	31
Native Americans	17,100	24,931	102,271	197,300	201,387	46	310	93	2
Islanders	—	—	—	19,370	28,948	—	—	—	49
Asian[2]	240,806	414,340	603,426	893,590	1,103,587	72	46	48	24

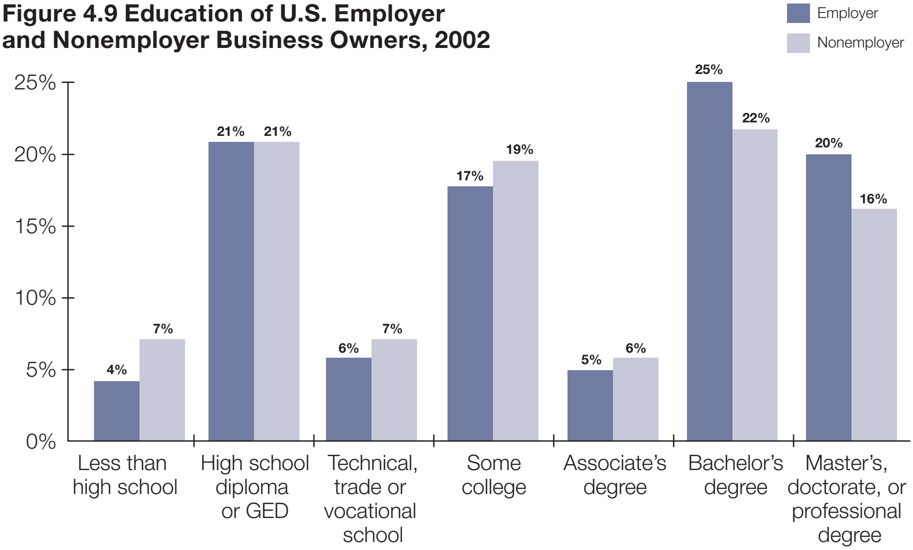
— Data are not available.

[1] The number of non-Hispanic White-owned businesses for 2002 was estimated by subtracting 82 percent of Hispanic-owned firms from the 2002 SBO reported White-owned firms, assuming that 18 percent of all Hispanic business owners were non-White.

[2] Undercounts for Asians and Pacific Islanders, American Indians and Alaska Natives are estimated based on total undercounts for the combined categories.

Data sources: U.S. Small Business Administration, Office of Advocacy, based on data from the U.S. Census Bureau, Survey of Minority-owned Business Enterprises, Company Statistics Series, 1982, 1987, 1992, 1997, and 2002.

Figure 4.9 Education of U.S. Employer and Nonemployer Business Owners, 2002



Data Source: U.S. Census Bureau, 2002 Survey of Business Owners, Characteristics of Business Owners, released September 27, 2006.

The Minority Population and Their Human Capital

Approximately 68 percent of the U.S. population was non-Hispanic White in 2002. The Hispanic population was surveyed to determine the subgroups within the group. About 7.6 percentage points of the 13.5 percent Hispanic share of the population were White, and the remaining 5.9 percent were Hispanic of other races (Table 4.17). Hispanics formed the largest U.S. minority community, followed by Black, about 12 percent in 2002. Asians accounted for 4 percent.

Asians between 15 and 24 constituted 10.4 percent of the Asian population, just over half of that age group's share of the Hispanic, Native American, and Islander populations (Table 4.18). This may be because 64.3 percent of Asians were not born in the United States. Hispanics had the highest proportion, 44.1 percent, of the population at the typically high productivity ages of 25 to 39, followed by Asians, 41 percent. Both Whites and Asians had relatively high proportions of their population between 50 and 59, 19.3 percent and 17.8 percent, respectively.

Of the Asian population, 35.4 percent had a bachelor's degree or higher level of education. Comparable shares were 22 percent for Whites, 16.4 percent for Islanders, 10.9 percent for Blacks, 9.2 percent for Native Americans, and

Table 4.17 U.S. Population by Race and Hispanic or Latino Origin, 2002	Estimate	Percent
Total	280,540,330	100.00
White alone (including Hispanic White)	212,541,793	75.76
Non-Hispanic White	191,238,314	68.17
Black alone (including Hispanic Black)	33,768,036	12.04
Non-Hispanic Black	33,175,449	11.83
American Indian and Alaska Native alone (including Hispanic Indian)	1,959,347	0.70
Non-Hispanic American Indian and Alaska Native	1,651,069	0.59
Asian alone (including Hispanic Asian)	11,213,133	4.00
Non-Hispanic Asian	11,113,311	3.96
Native Hawaiian and other Pacific Islander alone (including Hispanic Islander)	365,474	0.13
Non-Hispanic Native Hawaiian and other Pacific Islander	331,228	0.12
Some other race alone (including Hispanic some other race alone)	14,187,100	5.06
Non-Hispanic some other race alone	655,179	0.23
Two or more races: (including Hispanic two or more races)	6,505,447	2.32
Non-Hispanic two or more races	4,503,305	1.61
Two races including some other race	1,768,590	0.63
Two races excluding some other race, and three or more races	4,736,857	1.69
Hispanic or Latino of any race	37,872,475	13.50

Note: The percent sum of all shaded rows should be 100 (within rounding error).

Data source: U.S. Census Bureau, 2002 American Community Survey, http://factfinder.census.gov/servlet/ADPTable?_bm=y&-geo_id=01000US&-ds_name=ACS_2002_EST_G00_&-_lang=en&-_caller=geoselect&-format=.

6.8 percent for Hispanics. Just over one-third, 35.7 percent, of Asians were native U.S. citizens. More than 40 percent of Hispanics were foreign-born.

The Minority Labor Force, Self-employed, Professionals, and Moonlighters

An important component of the U.S. labor force and economy, minorities have contributed their skills and labor, along with other kinds of capital, to the U.S. economy. The extent of minorities' participation in business and production can be examined using a data set from the U.S. Census Bureau's 2005 Current Population Survey, March Supplement.

The Census definitions of workers' occupations are used here. "Professionals" include those in management, business, and financial occupations, and professional and related occupations. "Moonlighters" are people involved in more than one job that may be wage-and-salary work and/or

Table 4.18 Social and Economic Profile of the U.S. Population by Race and Hispanic or Latino Origin, 2004 (percent of each minority population)

	Hispanic	White	Black	Native American	Asian	Islander
Age groups (15 years and older)						
15-24	19.0	14.8	16.1	19.4	10.4	21.3
25-39	44.1	32.0	36.9	36.0	41.0	39.0
40-49	21.7	25.4	25.6	24.8	24.6	21.5
50-59	11.3	19.3	15.7	14.2	17.8	13.8
60 and over	4.0	8.5	5.6	5.7	6.2	4.4
Education level						
Children	29.2	18.0	25.4	24.5	19.2	17.5
Less than high school	31.8	12.5	19.0	22.5	13.7	13.2
High school degree	18.8	25.3	25.5	23.1	15.4	27.2
Some college	13.4	22.3	19.3	20.7	16.4	25.7
Bachelor's degree	4.9	14.5	7.8	6.6	23.1	12.2
Post-graduate	1.7	6.5	2.8	2.0	10.3	3.9
Ph.D.	0.2	1.0	0.3	0.6	2.0	0.3
Citizenship						
Native U.S. citizen	59.8	96.1	92.8	96.5	35.7	66.5
Naturalized	9.8	2.1	3.3	1.2	33.2	17.6
Not a U.S. citizen	30.4	1.8	4.0	2.3	31.1	15.9
Marital status						
Married	35.0	46.7	25.0	32.8	49.3	39.8
Not married	10.2	14.9	16.0	17.0	8.6	13.1
Never married	54.7	38.4	59.0	50.2	42.1	47.2

Data source: U.S. Census Bureau, 2005 Current Population Survey, March Supplement.

self-employment. Services are those in service occupations, sales and related occupations, and office and administrative support occupations. Other occupations are those in farming, fishing, and forestry; construction and extraction; installation, maintenance, and repair; production; transportation and material moving; and armed forces.

Islanders and Asians had the largest shares of their labor forces working in the private sector in 2004, 78.6 percent and 76.6 percent, respectively (Table 4.19). Government employed 28.3 percent of Native Americans and 18.4 percent of Blacks. Of professionals, 15.5 percent of Whites were self-employed, compared with 14.3 percent of Hispanics, 11.8 percent of Islanders, 10.5 percent each of Asians and Native Americans, and 6.2 percent of Blacks. Larger shares of Native American and Black professionals were government

Table 4.19 Minorities in the Labor Force by Worker Classification, 2004 (percent)

	Hispanic	White	Black	Native American	Asian	Islander
All labor force						
Private	73.0	72.5	75.5	61.4	76.6	78.6
Government	15.0	14.6	18.4	28.3	11.7	13.4
Self-employed	11.4	12.5	5.0	9.4	10.9	7.2
Without pay	0.1	0.1	0.0	0.0	0.2	0.0
Never worked	0.5	0.4	1.1	0.9	0.5	0.8
Professionals						
Private	63.0	62.5	60.7	46.3	73.8	62.1
Government	22.7	22.0	33.1	43.3	15.6	26.1
Self-employed	14.3	15.5	6.2	10.5	10.5	11.8
Moonlighters						
Not in universe	3.9	3.9	4.2	1.5	2.0	0.0
Private	52.5	50.9	65.8	48.2	64.6	80.6
Government	14.3	14.2	15.9	34.8	12.4	9.7
Self-employed	29.2	30.9	14.1	15.5	21.0	9.7

Data source: U.S. Census Bureau, 2005 Current Population Survey, March Supplement.

workers—43.3 percent and 33.1 percent, respectively. Government employed 34.8 percent of Native American moonlighters.

Of moonlighters, 80.6 percent of Islanders worked in the private sector, compared with 48.2 percent of Native Americans.

According to the 2002 SBO, more than 50 percent of the owners of employer firms reported working overtime (more than 40 hours per week, on average), compared with 26 percent of the owners of nonemployer firms. In contrast, 63 percent of the owners of nonemployer respondent firms reported working less than 40 hours a week, compared with 33 percent of employer firm owners. About 40 percent of nonemployer firm owners and 20 percent of employer firm owners reported working less than 20 hours a week. Seven percent of owners of all respondent firms, both employers and nonemployers, reported working no hours at all in their business in 2002. More than 80 percent of the Islander, Asian, and Hispanic labor forces worked full time in 2004, compared with about three-quarters of Whites, Blacks, and Native Americans (Table 4.20). The unemployed share of the labor forces by race ranged from just over 4 percent for Asians and Whites to more than 10 percent for Native

Table 4.20 Minorities in the Labor Force by Work Schedule, 2004 (percent)

	Hispanic	White	Black	Native American	Asian	Islander
All labor force						
Full-time[1]	80.2	77.0	76.4	74.9	81.4	81.7
Part-time[2]	13.4	18.4	12.7	12.9	14.5	12.6
Unemployed[3]	6.4	4.6	10.9	12.2	4.1	5.7
Self-employed						
Not in labor force	1.6	0.7	1.6	0.3	0.9	—
Full-time[1]	79.9	75.5	72.3	65.4	84.6	80.2
Part-time[2]	14.7	22.2	18.7	26.3	12.9	19.8
Unemployed[3]	3.8	1.6	7.5	8.1	1.7	—
Professionals						
Not in labor force	0.9	0.7	0.7	—	0.9	—
Full-time[1]	85.3	83.3	87.2	86.8	86.7	80.5
Part-time[2]	10.8	13.9	7.9	11.2	10.3	17.0
Unemployed[3]	3.0	2.1	4.2	2.0	2.0	2.5
Moonlighters						
Not in universe or labor force	5.5	4.4	4.7	1.5	2.0	—
Full-time[1]	76.9	75.0	82.6	75.8	83.1	77.4
Part-time[2]	11.5	18.5	8.4	18.5	14.5	22.6
Unemployed[3]	6.0	2.0	4.4	4.2	0.4	—

— Data are not available because of small samples in the survey.
[1] Including full-time schedules and part-time for economic reasons, but usually worked full-time.
[2] Including part-time for economic or noneconomic reason, usually worked part-time.
[3] Including full-time and part-time unemployment.
Data source: U.S. Census Bureau, 2005 Current Population Survey, March Supplement.

Americans and Blacks. Lower rates of unemployment are seen among the self-employed, professional, and moonlighter populations. More than 80 percent of professionals in every ethnic or racial group worked full time, and unemployment in this professional group ranged from 2 to 4 percent by minority status.

Professionals' share of the labor force by minority group ranged from 16.5 percent for Hispanics to 44.1 percent for Asians (Table 4.21). More than 45 percent of self-employed Whites and Islanders were professionals. Employment in services ranged from about 40 percent of the Asian and White labor forces to about 50 percent for Blacks. Of moonlighters, professionals constituted between about 30 and 52 percent by minority group and service employees between 14 and 50 percent.

Patterns of personal income vary considerably by the racial/ethnic group and the labor force, self-employment, professional, or moonlighter attributes

Table 4.21 Minorities in the Labor Force by Occupation, 2004 (percent)

	Hispanic	White	Black	Native American	Asian	Islander
All labor force						
Professionals[1]	16.5	37.8	24.6	25.2	44.1	27.5
Service providers[2]	45.9	40.1	50.2	44.4	39.0	45.6
Other occupations[3]	37.6	22.0	25.2	29.9	16.9	26.9
Self-employed						
Professionals[1]	23.4	46.7	29.8	28.3	42.2	45.2
Service providers[2]	43.8	32.8	41.2	34.5	41.9	14.0
Other occupations[3]	32.8	20.5	29.0	37.2	15.9	40.8
Moonlighters						
Not in universe	3.2	3.9	4.2	1.5	2.0	—
Professionals[1]	29.4	43.7	39.9	40.5	49.2	51.9
Service providers[2]	41.1	33.7	33.7	50.1	34.3	13.8
Other occupations[3]	26.3	18.7	22.1	7.9	14.5	34.3

— Data are not available because of small sample size in the survey.
[1] Professionals include management, business, and financial occupations and professional and related occupations.
[2] Services include service. sales and related, and office and administrative support occupations.
[3] Other occupations include farming, fishing, and forestry; construction and extraction; installation, maintenance, and repair; production; and transportation and material moving occupations; and armed forces.
Data source: U.S. Census Bureau, 2005 Current Population Survey, March Supplement.

of the work (Table 4.22). Asians and Whites in the labor force were relatively more represented in the middle to higher levels of income, while Hispanics, Native Americans, and Blacks were more dominant in the lower to middle income levels. For example, more than 85 percent of the Hispanic labor force had personal income under $40,000 in 2004 compared with 60 percent of Asians and Whites.

Self-employment tended to increase the share of each group in the top income level over $100,000, but also increased the share in the bottom income level under $20,000 for Whites, Blacks, and Native Americans. Professionals and moonlighters tended to be more evenly distributed across all income levels. As with the self-employed labor force, significantly higher percentages of professionals and moonlighters had personal incomes of $100,000 or more. The largest shares in the top income bracket were Islander and Asian moonlighters, 25.3 percent and 23.2 percent, respectively.

Most Asians and Hispanics in the U.S. labor force are immigrants, either naturalized or not (Table 4.23). Among self-employed Asians, 80.8 percent are immigrants, compared with 67.9 percent of Islanders and 56.8 percent

Table 4.22 Minorities in the Labor Force by Personal Income Classification, 2004 (percent)

Personal Income	Hispanic	White	Black	Native American	Asian	Islander
All labor force						
<$20,000	49.3	28.9	41.3	42.3	29.3	34.4
$20,000-<$40,000	36.0	31.5	39.6	35.5	29.3	36.2
$40,000-<$60,000	12.1	19.4	15.0	13.5	18.6	17.7
$60,000-<$80,000	4.2	10.0	5.9	5.8	10.0	7.9
$80,000-<$100,000	1.4	4.6	2.1	3.2	5.5	4.1
≥$100,000	2.3	7.4	2.5	1.8	9.0	2.8
Self-employed						
<$20,000	44.3	30.8	44.8	51.7	22.2	31.0
$20,000-<$40,000	25.4	25.3	26.5	27.6	27.7	37.1
$40,000-<$60,000	13.8	15.6	12.3	4.4	19.4	11.2
$60,000-<$80,000	7.3	9.7	6.2	9.9	9.4	4.0
$80,000-<$100,000	2.9	5.2	4.4	2.3	4.3	4.5
≥$100,000	6.3	13.4	5.8	4.2	17.0	12.2
Professionals						
<$20,000	21.3	15.1	17.0	18.3	12.4	16.2
$20,000-<$40,000	33.5	24.4	36.3	37.0	21.4	21.6
$40,000-<$60,000	21.9	23.7	23.8	21.9	23.8	26.0
$60,000-<$80,000	11.2	14.7	11.6	10.9	16.0	18.7
$80,000-<$100,000	4.2	7.9	5.0	6.3	9.9	9.5
≥$100,000	8.0	14.1	6.4	5.5	16.5	8.0
Moonlighters						
<$20,000	28.3	23.8	24.2	30.8	18.9	19.6
$20,000-<$40,000	23.7	25.5	25.0	1.0	23.0	21.5
$40,000-<$60,000	24.4	19.6	21.4	37.9	14.9	21.9
$60,000-<$80,000	7.8	11.7	14.6	20.9	9.3	11.7
$80,000-<$100,000	3.7	5.1	5.2	—	10.8	—
≥$100,000	12.2	14.3	9.7	9.4	23.2	25.3

— Data are not available because of small samples in the survey.
Data source: U.S. Census Bureau, 2005 Current Population Survey, March Supplement.

of Hispanics. Asians tended to have the highest shares of naturalized citizens in all work categories (labor force, self-employment, professional, and moonlighter) and vied with Hispanics for the highest shares of non-U.S. citizens. Large shares—85 to 98 percent—of Whites, Native Americans, and Blacks in all work categories are native U.S. citizens. Islanders reflect the most variation across work categories—88.3 percent of Islander moonlighters

Table 4.23 Minorities in the Labor Force by Citizenship Classification, 2004 (percent)

	Hispanic	White	Black	Native American	Asian	Islander
All labor force						
Native U.S. citizen	44.8	95.9	89.6	94.0	22.8	63.0
Naturalized	13.9	2.1	5.0	1.7	43.4	20.0
Not a U.S. citizen	41.4	2.0	5.4	4.3	33.8	17.0
Self-employed						
Native U.S. citizen	43.2	95.1	84.9	97.7	19.2	32.1
Naturalized	18.9	3.0	8.0	2.3	54.4	52.8
Not a U.S. citizen	37.9	1.9	7.1	—	26.4	15.1
Professionals						
Native U.S. citizen	68.0	95.6	89.7	92.4	21.7	58.9
Naturalized	16.5	2.4	6.0	0.0	43.2	28.1
Not a U.S. citizen	15.5	2.0	4.3	7.6	35.1	13.0
Moonlighters						
Native U.S. citizen	59.5	97.0	92.2	94.4	26.3	88.3
Naturalized	9.6	1.6	4.0	—	45.1	11.7
Not a U.S. citizen	31.0	1.4	3.9	5.6	28.7	—

— Data are not available because of small survey sample size.
Note: Native U.S. citizen includes born in U.S. mainland and outlying areas and in a foreign country to U.S. parents.
Data source: U.S. Census Bureau, 2005 Current Population Survey, March Supplement.

are native-born U.S. citizens, compared with 32.1 percent of Islander self-employed people, and 58.9 percent of Islander professionals.

Veteran Business Owners and Minority Veterans

Three million respondent U.S. military veterans accounted for almost 15 percent of the business owner respondents to the 2002 Survey of Business Owners. More than 66 percent owned the majority interest in a business; 26.8 percent owned equal interest; and 7.1 percent owned a nonmajority interest. Of the respondents, 811,000 veterans owned firms with paid employees; more than 2.1 million owned firms without. Veterans were majority owners of 70 percent of the veteran-owned employer firms and 56 percent of the veteran-owned nonemployer firms. Nearly 7 percent of the veteran respondents were service-disabled—that is, they had injuries incurred or aggravated in active military service. Veterans were distributed differently by racial and Hispanic origin and business characteristic (Table 4.24).

Table 4.24 Minorities in the Labor Force by Veteran Status, 2004 (percent)

	Hispanic	White	Black	Native American	Asian	Islander
All labor force						
With veteran status	3.3	9.8	7.7	10.5	2.2	6.9
Without veteran status	96.7	90.2	92.3	89.5	97.8	93.1
Self-employed						
With veteran status	5.2	13.6	11.4	20.2	2.7	7.7
Without veteran status	94.8	86.4	88.6	79.8	97.3	92.3
Professionals						
With veteran status	4.8	9.4	7.7	12.9	2.0	4.9
Without veteran status	95.2	90.6	92.3	87.1	98.0	95.1
Moonlighters						
With veteran status	4.4	11.0	10.8	0.9	6.3	31.3
Without veteran status	95.6	89.0	89.2	99.1	93.7	68.7

Data source: U.S. Census Bureau, 2005 Current Population Survey, March Supplement.

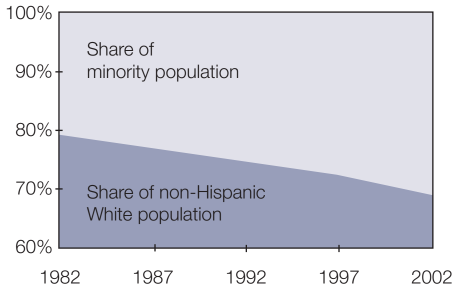
Business Density

The U.S. minority population continues to expand. Minorities constituted 21 percent of the population in 1982 and 32 percent in 2002 (Figure 4.10). Minorities' share of business ownership has been growing as well, from 7 percent in 1982 to 18 percent in 2002 (Figure 4.11). While the increase in business ownership has been substantial, the gap remains large.

Business density, defined as the number of businesses per 1,000 persons in a given population, is useful as an index of the gap between minorities' share of the population and their share of businesses (Table 4.25). For example, business density for Blacks increased significantly, by 38 percent, over the 1997-2002 period, from 24 firms per 1,000 persons in 1997 to 33 firms in 2002. Asian business density grew 5 percent, Hispanic, 2 percent over the five-year period. Business density for Whites dropped 4 percent, Native Americans 8 percent, and Islanders 3 percent.[12]

12 It should be emphasized that the 2002 business density was calculated using both population and firm ownership data that reflect the assumption that Hispanic persons can be of any race and a person identified as any race may be Hispanic. This differs from the assumption of the 1997 data that a White person was non-Hispanic and a White-owned firm was a non-Hispanic-owned firm.

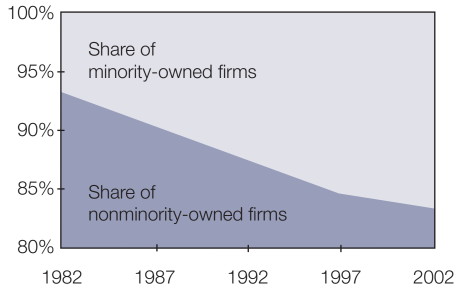
Figure 4.10 Composition of Minority vs. Nonminority Populations, 1982-2002



Number in thousands	1982	1987	1992	1997	2002
All U.S. Population	231,664	242,289	255,002	267,636	280,540
Non-Hispanic White	79%	77%	75%	73%	68%
Minority	21%	23%	25%	27%	32%

Note: The U.S. minority population was 21 percent of the total in 1982; it increased to 32 percent in 2002.
Data Source: U.S. Census Bureau.

Figure 4.11 Composition of Minority- vs. Nonminority-owned Firms, 1982-2002



Number in thousands	1982	1987	1992	1997	2002
All U.S. firms	12,060	13,695	17,253	20,822	22,975
Nonminority-owned firms	93%	90%	87%	85%	82%
Minority-owned firms	7%	10%	13%	15%	18%

Note: U.S. minority-owned firms were 7 percent of the total in 1982; they increased to 18 percent in 2002.
Data Source: U.S. Census Bureau.

Conclusion

For a number of years, policymakers have pursued policies aimed at fostering minority business ownership as a means of improving the economic well-being of minorities in the United States. Minorities have been making progress in business ownership. With more participation in higher education and the marketplace, minorities have continued to expand their productive capital in knowledge and entrepreneurial experience. In 1982, minorities owned 7 percent of U.S. firms; 20 years later, they owned 18 percent. Black-owned firms increased by 45 percent in just five years from 1997 to 2002; Hispanic-owned firms increased 31 percent.

Table 4.25 Business Density by Race and Hispanic or Latino Origin, 1997 and 2002

	Number of 2002 population[4] (thousands)	Number of 2002 firms[5]	2002 business density	Number of 1997 population[6] (thousands)	Number of 1997 firms[7]	1997 business density	Change in business density (percent)
Total population	285,933	22,974,655	80	269,094	20,821,934	77	4
Hispanic[1]	39,384	1,573,464	40	30,773	1,199,896	39	2
White[2]	230,809	19,899,839	86	192,178	17,316,796	90	-4
Black	35,806	1,197,567	33	33,768	823,499	24	38
Native American	2,284	201,387	88	2,046	197,300	96	-8
Asian	11,558	1,103,587	95	9,812	893,590	91	5
Islander[3]	786	28,948	37	516	19,370	38	-3

[1] Hispanic or Latino of any race.

[2] 2002 data included Hispanic White. 1997 White-owned firm data did not include White Hispanic or Latino.

[3] 1997 Islander population and business number data were estimated.

[4] *Data source:* 2003 Current Population Survey, March Supplement for 2002 actual population data. Hispanic population can be of any race; and all races may be Hispanic.

[5] *Data source:* U.S. Census Bureau, 2002 Survey of Business Owners.

[6] *Data source:* U.S. Census Bureau, 1998 Current Population Survey, March Supplement for 1997 actual population data.

[7] *Data source:* U.S. Census Bureau, 1997 Survey of Minority-owned Business Enterprises.

APPENDIX 4A
Tables

Table 4A.1 Summary Statistics: Comprehensive Information about U.S. Businesses by Hispanic or Latino Origin and Race, 2002 and 1997

2002 SBO Group	Number of firms	Receipts (thousands of dollars)	Number of employer firms	Receipts for employers (thousands of dollars)	Number of employees	Annual payroll (thousands of dollars)
All firms	22,974,655	22,603,658,904	5,524,784	21,836,249,354	110,766,605	3,812,427,806
Hispanic	1,573,464	221,927,425	199,542	179,507,959	1,536,795	36,711,718
White[1]	19,899,839	8,277,812,084	4,712,119	7,603,717,868	51,966,004	1,541,628,880
Black	1,197,567	88,641,608	94,518	65,799,425	753,978	17,550,064
Native American	201,387	26,872,947	24,498	21,986,696	191,270	5,135,273
Asian	1,103,587	326,663,445	319,468	291,162,771	2,213,948	56,044,960
Islander	28,948	4,279,591	3,693	3,502,157	29,319	826,217
Female-owned	6,489,259	939,538,208	916,657	802,851,495	7,141,369	173,528,707
Male-owned	13,184,033	7,061,026,736	3,524,969	6,564,052,308	42,428,508	1,319,884,315
Equally owned	2,693,360	731,678,703	717,961	627,202,424	5,664,948	129,700,997
Publicly held[2]	494,399	13,820,117,758	352,720	13,796,996,645	55,398,389	2,185,642,376
1997 SMOBE Group						
Total	20,821,934	18,553,243,047	5,295,151	17,907,940,321	103,359,815	2,936,492,940
Hispanic	1,199,896	186,274,582	211,884	158,674,537	1,388,746	29,830,028
White[3]	17,316,796	7,763,010,611	4,372,817	7,252,270,327	54,084,357	1,395,150,230
Black	823,499	71,214,662	93,235	56,377,860	718,341	14,322,312
Native American	197,300	34,343,907	33,277	29,226,260	298,661	6,624,235
Asian[4]	893,590	302,794,625	286,976	274,569,397	2,169,032	45,395,276
Female-owned	5,417,034	818,669,084	846,780	717,763,965	7,076,081	149,115,699
Male-owned	11,374,194	6,635,374,691	S	6,270,252,935	43,532,114	1,187,720,761
Equally owned	49,593	12,609,570	16,784	10,486,762	112,669	2,347,548

Publicly held[5]	381,519	10,161,241,786	—	10,104,057,581	44,458,403	1,437,194,875

S = Estimates are suppressed when publication standards are not met, for example, when the firm count is less than 3 or the relative standard error in sales and receipts is 50 percent or more.

— Data are not available.

[1] Including Hispanic White.

[2] Including other racially or ethnically unidentifiable firms.

[3] Non-Hispanic White.

[4] Including Native Hawaiian and other Pacific Islander.

[5] Including foreign-owned and nonprofit.

Note: The 2002 SBO and 1997 SMOBE are not comparable. Readers should be cautious when using the percentage change data.

Data sources: U.S. Census Bureau, 2002 Survey of Business Owners and 1997 Survey of Minority-owned Business Enterprises.

Table 4A.2 Number of U.S. Firms with Paid Employees by Employment Size of Firm, Hispanic or Latino Origin, and Race, 2002

		Firm employment size							
	All firms	No employees	1 to 4	5 to 9	10 to 19	20 to 49	50 to 99	100 to 499	500 or more
Total employer firms	5,524,784	810,950	2,600,314	948,715	581,596	368,797	116,060	81,616	16,736
Female	916,657	161,308	461,868	149,054	82,945	43,191	11,061	6,572	659
Male	3,524,969	504,696	1,666,267	609,788	377,383	240,610	74,252	46,185	5,786
Equal	717,961	107,199	341,143	133,544	79,818	42,367	9,316	4,298	277
Publicly held	352,720	37,304	124,252	51,443	41,824	40,709	21,586	25,823	9,778
Hispanic	199,542	36,767	99,568	31,487	18,402	9,021	2,789	1,326	182
White	4,712,119	693,170	2,247,625	817,434	499,168	304,564	89,478	54,191	6,489
Black	94,518	19,305	46,968	14,143	7,437	4,415	1,282	881	88
Native American	24,498	4,712	12,237	3,662	2,153	1,221	336	155	23
Asian	319,468	54,251	160,757	54,690	29,714	14,914	3,277	1,738	128
Islander	3,693	752	1,644	573	408	232	56	28	—

— = zero.
Data source: U.S. Census Bureau, 2002 Survey of Business Owners: Company Summary, released September 14, 2006.

Table 4A.3 Sales and Receipts of U.S. Employer Firms by Employment Size of Firm, Hispanic or Latino Origin, and Race, 2002 (millions of dollars)

		Firm employment size							
	All firms	No employees	1 to 4	5 to 9	10 to 19	20 to 49	50 to 99	100 to 499	500 or more
Total employer firms	21,836,249	207,263	880,089	856,365	1,045,413	1,559,296	1,246,357	2,517,174	13,524,291
Female	802,851	23,539	113,447	96,282	103,160	117,875	74,053	114,484	160,012
Male	6,564,052	121,155	601,950	589,985	734,181	1,096,260	831,318	1,381,641	1,207,562
Equal	627,202	20,561	108,339	103,082	108,123	120,831	60,729	69,433	36,104
Publicly held	13,796,997	43,727	54,841	59,200	103,351	211,736	261,458	952,828	12,109,856
Hispanic	179,508	6,703	28,292	26,627	26,945	29,496	19,447	27,206	14,792
White	7,603,718	150,507	751,560	730,899	887,747	1,266,635	921,509	1,516,475	1,378,386
Black	65,799	2,986	10,679	7,773	7,769	10,912	9,697	11,193	4,790
Native American	21,987	1,021	3,378	2,411	2,996	3,814	3,092	2,842	2,433
Asian	291,163	10,287	56,967	46,155	44,109	50,950	30,759	32,955	18,980
Islander	3,502	73	520	413	574	805	420	698	—

— = zero.
Data source: U.S. Census Bureau, 2002 Survey of Business Owners: Company Summary, released September 14, 2006.

Table 4A.4 Asian-owned Firms by Ethnicity, 2002 (millions of dollars)

SBO group	Number of firms	Receipts (thousands of dollars)	Number of employer firms	Receipts of employers (thousands of dollars)	Number of employees	Annual payroll (thousands of dollars)	Number of non-employer firms	Receipts of nonemployers (thousands of dollars)
Asian total	1,103,587	326,663,445	319,468	291,162,771	2,213,948	56,044,960	784,118	35,500,674
Asian Indian	223,212	88,128,188	82,422	80,132,371	610,070	17,557,228	140,791	7,995,817
Chinese	286,041	105,051,613	89,049	95,730,230	649,106	15,269,910	196,992	9,321,383
Filipino	125,146	14,155,210	19,888	10,952,902	131,929	3,586,220	105,258	3,202,308
Japanese	86,910	30,623,111	22,166	27,854,820	205,423	5,780,834	64,743	2,768,291
Korean	157,688	46,960,761	57,078	41,294,379	320,594	6,702,438	100,610	5,666,383
Vietnamese	147,036	15,512,490	25,591	11,532,963	125,838	2,811,939	121,445	3,979,527
Other Asian	89,118	24,275,706	24,835	21,730,347	160,754	3,792,678	64,283	2,545,359

Data source: U.S. Census Bureau, 2002 Survey of Business Owners: Asian-owned Firms.

Table 4A.5 Hispanic-owned Firms by Ethnicity, 2002

SBO group	Number of firms	Receipts (thousands of dollars)	Number of employer firms	Receipts of employers (thousands of dollars)	Number of employees	Annual payroll (thousands of dollars)	Number of non-employer firms	Receipts of nonemployers (thousands of dollars)
Hispanic total [1]	1,573,464	221,927,425	199,542	179,507,959	1,536,795	36,711,718	1,373,922	42,419,467
Mexican[2]	701,078	96,735,081	89,285	77,368,768	720,288	15,909,481	611,793	19,366,313
Puerto Rican	109,475	12,340,353	11,830	9,578,771	77,266	2,112,028	97,645	2,761,583
Cuban	151,688	35,443,349	27,863	30,900,000	206,032	5,927,323	123,825	4,543,349
Other[3]	596,125	74,219,213	67,326	59,132,355	503,620	12,072,351	528,799	15,086,859

[1] Hispanic or Latino.
[2] Mexican, Mexican American, Chicano.
[3] Other Spanish/Hispanic/Latino.
Data source: U.S. Census Bureau, 2002 Survey of Business Owners: Hispanic-owned Firms.

Table 4A.6 Average Business Receipts per Firm, by Hispanic or Latino Origin and Race, 1997 and 2002 (dollars)

	Receipts per firm		Receipts per employer firm		Receipts per nonemployer firm	
Business groups	2002	1997	2002	1997	2002	1997
Total U.S. businesses	983,852	891,043	3,952,417	3,381,951	43,978	41,561
Female	144,784	151,129	875,847	847,639	24,528	22,079
Male	535,574	583,371	1,862,159	NA	51,452	46,287
Equally owned	271,660	254,261	873,588	624,807	52,889	44,219
Publicly held	27,953,370	26,633,646	39,116,004	NA	163,193	503,491
Hispanic	141,044	155,242	899,600	748,874	30,875	27,935
White	415,974	448,294	1,613,651	1,658,489	44,384	39,458
Black	74,018	86,479	696,158	604,686	20,708	20,317
Native American	133,439	174,070	897,489	878,272	27,623	31,203
Asian	296,002	338,852	911,399	956,768	45,275	46,529
Islander	147,837	213,629	948,323	1,232,220	30,783	25,265

NA = Not available.
Data sources: U.S. Census Bureau, 2002 Survey of Business Owners and 1997 Survey of Minority-owned Business Enterprises.

Table 4A.7 Household Income Percentiles of U.S. Minorities, 2004 (percent)						
Household income percentile	Hispanic	White	Black	Native American	Asian	Islander
Total population						
Lowest 20 percent	19.3	11.5	26.8	24.1	10.1	10.6
Second 20 percent	25.2	15.3	22.6	21.9	12.3	20.8
Third 20 percent	23.7	19.7	20.3	23.6	19.9	21.4
Fourth 20 percent	18.3	24.6	17.9	18.2	21.6	23.1
Top 20 percent	13.5	28.9	12.5	12.2	36.1	24.0
Labor force						
Lowest 20 percent	13.3	6.4	16.8	15.8	6.5	9.2
Second 20 percent	27.6	15.7	26.9	25.6	12.8	20.3
Third 20 percent	23.1	19.0	19.9	21.2	19.8	19.5
Fourth 20 percent	14.3	17.9	15.1	14.5	15.5	18.9
Top 20 percent	8.7	13.2	8.9	9.6	11.6	8.9
Self-employed						
Lowest 20 percent	17.5	8.9	19.9	23.1	5.9	23.2
Second 20 percent	23.6	16.2	23.4	28.5	12.4	6.5
Third 20 percent	17.5	17.1	17.5	15.9	19.4	7.3
Fourth 20 percent	13.4	15.3	13.8	17.8	12.6	40.9
Top 20 percent	9.1	10.8	8.0	8.0	7.5	3.4
Professionals						
Lowest 20 percent	5.0	3.0	6.6	7.5	3.1	8.3
Second 20 percent	16.3	9.4	19.9	16.5	7.1	1.7
Third 20 percent	20.1	15.0	19.9	21.4	15.9	15.0
Fourth 20 percent	18.1	16.7	17.5	17.4	12.9	29.8
Top 20 percent	12.6	14.9	12.2	13.2	13.2	11.4
Moonlighters						
Lowest 20 percent	6.8	5.8	9.6	13.3	4.3	20.9
Second 20 percent	17.7	14.6	18.5	0.0	1.7	10.3
Third 20 percent	23.8	16.4	15.3	18.0	14.2	2.3
Fourth 20 percent	17.1	17.3	15.7	19.8	12.6	16.5
Top 20 percent	10.4	12.6	14.3	21.4	16.2	10.4

Data source: U.S. Census Bureau, Current Population Survey, 2005 March Supplement.

Table 4A.8 Household Dividend Income of U.S. Minorities, 2004 (percent)						
Household dividend income (HDIV_YN)	Hispanic	White	Black	Native American	Asian	Islander
Total population						
Yes	8.4	32.9	10.0	11.2	27.7	15.7
No	91.6	67.1	90.0	88.8	72.3	84.3
Labor force						
Yes	10.1	35.1	12.6	12.8	29.7	19.2
No	89.9	64.9	87.4	87.2	70.3	80.8
Self-employed						
Yes	14.7	41.2	13.0	17.4	32.1	34.9
No	85.3	58.8	87.0	82.6	67.9	65.1
Professionals						
Yes	23.1	46.5	20.1	23.4	40.4	37.9
No	76.9	53.5	79.9	76.6	59.6	62.1
Moonlighters						
Yes	22.9	45.8	26.1	27.6	40.8	41.9
No	77.1	54.2	73.9	72.4	59.2	58.1

Data source: U.S. Census Bureau, Current Population Survey, 2005 March Supplement.

Table 4A. 9 Household Interest Income of U.S. Minorities, 2004 (percent)						
Household interest income (HINT_YN)	Hispanic	White	Black	Native American	Asian	Islander
Total population						
Yes	27.8	62.2	30.5	34.4	53.6	43.4
No	72.2	37.8	69.5	65.6	46.4	56.6
Labor force						
Yes	31.8	65.0	36.3	38.4	56.8	48.8
No	68.2	35.0	63.7	61.6	43.2	51.2
Self-employed						
Yes	42.0	69.2	38.5	38.4	57.4	41.7
No	58.0	30.8	61.5	61.6	42.6	58.3
Professionals						
Yes	55.0	75.9	50.9	50.6	67.0	65.0
No	45.0	24.1	49.1	49.4	33.0	35.0
Moonlighters						
Yes	51.3	73.7	54.0	61.0	68.8	76.8
No	48.7	26.3	46.0	39.0	31.2	23.2

Data source: U.S. Census Bureau, Current Population Survey, 2005 March Supplement.

Table 4A.10 Household Rental Income of U.S. Minorities, 2004 (percent)						
Household rental income (HRNT_YN)	Hispanic	White	Black	Native American	Asian	Islander
Total population						
Yes	4.0	8.6	3.2	5.0	7.7	5.3
No	96.0	91.4	96.8	95.0	92.3	94.7
Labor force						
Yes	4.4	8.8	3.8	4.1	8.1	6.0
No	95.6	91.2	96.2	95.9	91.9	94.0
Self-employed						
Yes	11.0	17.9	7.3	7.0	14.9	11.2
No	89.0	82.1	92.7	93.0	85.1	88.8
Professionals						
Yes	8.4	11.4	6.7	5.0	8.4	9.9
No	91.6	88.6	93.3	95.0	91.6	90.1
Moonlighters						
Yes	9.3	15.7	7.6	4.0	16.3	15.6
No	90.7	84.3	92.4	96.0	83.7	84.4

Data source: U.S. Census Bureau, Current Population Survey, 2005 March Supplement.

Appendix 4B: Comparability of Minority Business Owner Survey, 1997 and 2002[13]

The following changes were made in survey methodology in 2002 which affect comparability with past reports:

1. The 1997 Surveys of Minority- and Women-owned Business Enterprises (SMOBE/SWOBE) form that was mailed to sole proprietors or self-employed individuals who were single filers or who filed joint tax returns instructed the respondent to mark one box that best described the gender, Spanish/Hispanic/Latino origin, and race of the primary owner(s). The gender question included an equal male/female ownership option. The 2002 SBO form that was mailed to sole proprietors or self-employed individuals who were single filers or who filed a joint tax return instructed the respondent to provide the percentage of ownership for each owner and the gender of the owner(s). The equal male/female ownership option was eliminated.

13 For Census information in addition to that included here as Appendices B and C, see http://www.census.gov/econ/census02/text/sbo/sbomethodology.htm.

The form that corporations/partnerships received in 1997 requested the percentage of ownership by gender of the owners. In 2002, a business was asked to report the percentage of ownership and gender for each of the three largest percentage owners.

Male/female ownership of a business in both 1997 and 2002 was based on the gender of the person(s) owning the majority interest in the business. However, in 2002, equally male/female ownership was based on equal shares of interest reported for businesses with male and female owners. Businesses equally male-/female-owned were tabulated and published as a separate entity in both 1997 and 2002.

The 1997 SWOBE/SMOBE forms may be viewed at www.census.gov/epcd/www/pdf/97cs/mb1.pdf (corporations/partnerships) or at www.census.gov/epcd/www/pdf/97cs/mb2.pdf (sole proprietors or self-employed individuals).

The 2002 SBO forms may be viewed at www.census.gov/csd/sbo/sbo1.pdf (corporations/partnerships) or at www.census.gov/csd/sbo/sbo2.pdf (sole proprietors or self-employed individuals).

2.The Hispanic or Latino origin and racial response categories were updated in 2002 to meet the latest Office of Management and Budget (OMB) guidelines. There were nineteen check-box response categories and four write-in areas on the 2002 SBO questionnaire, compared to the twenty check-box response categories and five write-in areas on the 1997 SMOBE/SWOBE.

The Hispanic or Latino origin of business ownership was defined as two groups:

•Hispanic or Latino
•Not Hispanic or Latino

Four Hispanic subgroups were used on the survey questionnaires: Mexican, Mexican American, Chicano; Puerto Rican; Cuban; and Other Spanish/Hispanic/Latino.

The 2002 SBO question on race included fourteen separate response categories and two areas where respondents could write in a more specific race. The response categories and write-in answers were combined to create the following five standard OMB race categories:

•American Indian and Alaska Native
•Asian
•Black or African American
•Native Hawaiian and Other Pacific Islander
•White

Response check boxes were added for "Samoan" and "Guamanian or Chamorro."

The check box for "Some Other Race" and the corresponding write-in area provided in 1997 were deleted.

If the "American Indian and Alaska Native" race category was selected, the respondent was instructed to print the name of the enrolled or principal tribe.

In 1997, sole proprietors or self-employed individuals who were single filers or who filed a joint tax return were asked to mark a box to indicate the Spanish/Hispanic/Latino origin of the primary owner(s) and to mark the one box that best described the race of the primary owner(s). In 2002, they were asked to provide the percentage of ownership for the primary owner(s), his/her Spanish/Hispanic/Latino origin, and to select one or more race categories to indicate what the owner considers himself/herself to be.

The form that corporations/partnerships received in 1997 requested the percentage of ownership by Spanish/Hispanic/Latino origin and race of the owners. In 2002, a business was asked to report the percentage of ownership, Spanish/Hispanic/Latino origin, and race for each of the three largest owners, allowing them to mark one or more races to indicate what the owner considers himself/herself to be. The 2002 SBO was the first economic census in which each owner could self-identify with more than one racial group, so it was possible for a business to be classified and tabulated in more than one racial group.

Business ownership in both 1997 and 2002 was based on the Hispanic or Latino origin and race of the person(s) owning majority interest in the business; however, in 2002, multiple-race reporting by the owner(s) could affect where a business was classified.

Note: In the 2000 population census, 2.4 percent of the population reported more than one race.

Source: U.S. Census Bureau, 2002 Economic Census,
http://www.census.gov/econ/census02/text/sbo/sbomethodology.htm

Appendix 4C: Sources of the Data, Sampling and Estimation Methodologies

The 2002 Survey of Business Owners (SBO) was conducted by mail. One of two census forms was mailed to a random sample of businesses selected from a list of all firms operating during 2002 with receipts of $1,000 or more, except those classified in the following NAICS industries:

- crop and animal production (NAICS 111, 112)
- scheduled air transportation (NAICS 4811, part)
- rail transportation (NAICS 482)
- postal service (NAICS 491)
- funds, trusts, and other financial vehicles (NAICS 525), except real estate investment trusts (NAICS 525930)
- religious, grantmaking, civic, professional, and similar organizations (NAICS 813)
- private households (NAICS 814), and
- public administration (NAICS 92).

The lists of all firms (or universe) are compiled from a combination of business tax returns and data collected on other economic census reports. The Census Bureau obtains electronic files from the Internal Revenue Service (IRS) for all companies filing IRS Form 1040, Schedule C (individual proprietorship or self-employed person); 1065 (partnership); any one of the 1120 corporation tax forms; and 941 (Employer's Quarterly Federal Tax Return). The IRS provides certain identification, classification, and measurement data for businesses filing those forms.

For most firms with paid employees, the Census Bureau also collected employment, payroll, receipts, and kind of business for each plant, store, or physical location during the 2002 Economic Census.

The report forms used to collect information are available at www.census.gov/csd/sbo/index.html.

The SBO is conducted on a company or firm basis rather than an establishment basis. A company or firm is a business consisting of one or more domestic establishments that the reporting firm specified under its ownership or control at the end of 2002. Firms were instructed to return their completed report form by mail. Two report form remails were conducted at one-month intervals to all delinquent respondents. A telephone follow-up was conducted to obtain a subset of information from selected firms that failed to return their report form. The returned forms underwent extensive review and computer processing. All reports were geographically coded, data-keyed, and edited. The editing process identified records with significant problems and firms were contacted for correction resolution. Corrections were performed interactively using standard procedures.

The data were then tabulated by NAICS, subjected to further data analysis, and the resulting corrections applied to individual computer records. Corrected tabulations were then produced for the final published reports.

A more detailed examination of census methodology is presented in the *History of the 2002 Economic Census* at www.census.gov/econ/www/history.html.

Industry Classification of Firms

The classifications for all establishments are based on the *North American Industry Classification System, United States, 2002,* manual. The kind-of-business or industry classification codes for the SBO are obtained from the 2002 Economic Census. More information on the industry classification codes is included in the Industry Classifications and Relationship to Historical Industry Classifications sections in the introductory text.

Sampling. To design the 2002 SBO sample, the Census Bureau used the following sources of information to estimate the probability that a business was minority- or women-owned:

- Administrative data from the Social Security Administration.
- Lists of minority- and women-owned businesses published in syndicated magazines, located on the Internet, or disseminated by trade or special interest groups.
- Word strings in the company name indicating possible minority ownership (derived from 1997 survey responses).
- Racial distributions for various state-industry classes (derived from 1997 survey responses) and racial distributions for various ZIP Codes.
- Gender, race, and Hispanic or Latino origin responses of a single-owner business to an SBO previous survey or to the 2000 Decennial Census.

These probabilities were then used to place each firm in the SBO universe in one of nine frames for sampling:

- American Indian
- Asian
- Black or African American
- Hispanic
- Non-Hispanic white men
- Native Hawaiian and Other Pacific Islander
- Other (a different race was supplied as a write-in to another source)
- Publicly owned
- Women

The SBO universe was stratified by state, industry, frame, and whether the company had paid employees in 2002. The Census Bureau selected large companies, including those operating in more than one state, with certainty. These companies were selected based on volume of sales, payroll, or number of paid employees. All certainty cases were sure to be selected and represented only themselves (i.e., had a selection probability of one and a sampling weight of one). The certainty cutoffs varied by sampling stratum, and each stratum was sampled at varying rates, depending on the number of firms in a particular industry in a particular state. The remaining universe was subjected to stratified systematic random sampling.

A firm selected into the sample was mailed one of two questionnaires. The Census Bureau sent the SBO-1 questionnaire to partnerships and corporations. The businesses were asked to report the percentage of ownership, gender, Hispanic or Latino origin, race, and several characteristic questions (e.g., age, education level) for each of the three largest percentage owners. The SBO-2 questionnaire was used for sole proprietors and self-employed individuals. The businesses were asked essentially the same information as asked on the SBO-1, but limited to two owners.

Treatment of Nonresponse. Approximately 81 percent of the 2.3 million businesses in the SBO sample responded to the survey. Data from the 1997 survey were used for businesses in both the 1997 and 2002 samples. For the remaining nonrespondents, gender, Hispanic or Latino origin, and race were imputed from donor respondents with similar characteristics (state, industry, employment status, size, and sampling frame).

Tabulation. Business ownership is defined as having 51 percent or more of the stock or equity in the business and is categorized by:

- Gender: Male; Female; or Equally Male-/Female-owned
- Ethnicity: Hispanic or Latino Origin; Not Hispanic or Latino Origin
- Race: White; Black or African American; American Indian or Alaska Native; Asian; Native Hawaiian or Other Pacific Islander
- Firms equally male-/female-owned were counted and tabulated as a separate category.
- Businesses could be tabulated in more than one racial group. This can result because:
    a. the sole owner reported more than one race;
    b. the majority owner reported more than one race;
    c. a majority combination of owners reported more than one race.

The detail may not add to the total or subgroup total because a Hispanic or Latino firm may be of any race, and because a firm could be tabulated in more than one racial group. For example, if a firm responded as both Chinese and Black majority owned, the firm would be included in the detailed Asian and Black estimates, but would only be counted once toward the higher level all firms' estimates.

The sum of the detailed Hispanic or Latino origin may not add to the total because no one Hispanic subgroup (i.e., Mexican, Puerto Rican, Cuban, or Other Spanish/Hispanic/Latino) owned a majority of the firm, but a combination of these subgroups did own a majority. For example, if a firm had two owners each with equal ownership, one responding Puerto Rican and the other responding Cuban, there is no one subgroup with a majority ownership, but the firm is Hispanic-owned. This firm would be tabulated in the Hispanic or Latino estimate, but would not appear in any of the subgroup estimates.

Also, the subgroup detail for both Asians and Native Hawaiians and Other Pacific Islanders may not add to the total for similar reasons as explained above.

In the Characteristics of Businesses and the Characteristics of Business Owners reports, the tabulations of demographic and economic business and owner characteristics included only those firms that returned the survey form and provided the gender, Hispanic or Latino origin, and race for the owner(s) or indicated the firm was publicly held. These tabulations also included the owners who identified with more than one race. For example, an Asian Hispanic male veteran owner would have his information tabulated in each of those four categories. However, such a record was counted only once in the "All owners of respondent firms" line of the publication.

For the tabulations by gender, Hispanic or Latino origin, and race, the data for each firm in the SBO sample were weighted by the reciprocal of the firm's probability of selection. The data for each owner are inflated using the sampling weight assigned to the owner's corresponding firm record.

5 Characteristics *of* Veteran Business Owners and Veteran-owned Businesses

Synopsis

The new Characteristics of Veteran-Owned Businesses (CVOB) and Characteristics of Veteran Business Owners (CVBO), produced by the U.S. Department of Commerce, Bureau of the Census (Census) are the most important new data on veterans and service-disabled veterans in business since an earlier report based on 1992 data. The scope of the new reports is also much broader, representing the most detailed information on veterans in business ever released by Census.

The data show the following about veteran business owner respondents to the Census surveys:

- They are overwhelmingly male (97.3 percent), non-Hispanic (97.7 percent) and White (95.5 percent).
- They tend to be older than all business owners (68 percent over age 55).
- They tend to be better educated than other business owners, being more likely to have postgraduate degrees and less likely not to have graduated from high school.
- More than half of employer veteran respondents reported working an average of more than 40 hours per week.
- The business was the primary source of personal income for 50.9 percent of all owners, 47.5 percent of all veteran owners, and 44.1 percent of all service-disabled veteran owners of the respondent firms.

With respect to the firms owned by veteran respondents, the data show, among other characteristics:

- Veteran-owned businesses are older than all U.S. firms generally.
- In terms of sales/receipts, both veteran-owned respondent firms and all respondent firms were nearly identical and they were similar in terms of employment size.

- Of veteran-owned respondent businesses, 51.8 percent reported operating from the owner's home, compared with 49.4 percent of all respondent businesses.
- Of veteran-owned respondent firms, 15.7 percent reported being family-owned and another 75.2 percent reported having only one owner, compared with 23.4 percent family ownership and 63.6 percent sole ownership reported by all respondent firms.

Introduction

Veterans of the armed forces are represented in every walk of life in the United States. Veterans are a vital part of the nation's population, the labor force, and the business sector. In 2005, the more than 24 million veterans of the armed forces represented one out of every nine persons in the United States aged 20 and over.[1] Veterans are an important group of entrepreneurs, and many veteran business owners have gained important skills from their active and reserve duty service that often are directly relevant to business ownership.

Businesses owned by veterans and by service-disabled veterans have been the subject of a special research effort by the U.S. Small Business Administration's Office of Advocacy since the enactment of the Veterans Entrepreneurship and Small Business Development Act of 1999.[2] Although considerable knowledge exists about the small business community as a whole, and there are also many sources of data about veterans, information on the intersection of these two populations has remained surprisingly elusive.

In recent years, the Office of Advocacy has been working to help fill this knowledge gap. It has commissioned a number of studies about veteran entrepreneurship issues, and it continues to work with other federal agencies to add value to existing data sources that may have veteran "markers" but have not been used to develop information on veterans in business. Advocacy-commissioned studies have found that:

1 U.S. Census Bureau, *2007 Statistical Abstract of the United States*, Tables 11 and 507, both accessible at http://www.census.gov/compendia/statab/.

2 Public Law 106-50; August 17, 1999.

- About 22 percent of veterans in the U.S. household population were either purchasing or starting a new business, or considering doing so.[3]
- Almost 72 percent of these new veteran entrepreneurs planned to employ at least one person at the outset of their venture.[4]
- About 23 percent of current veteran business owners, and 32 percent of those planning or in the process of starting a new business, indicated that their venture would be 50 percent or more Internet-dependent.[5]
- Military service appears to have provided necessary business skills to a significant proportion (one-third or more) of both current veteran business owners and those planning to become owners.[6]
- The self-employment rate of male veterans was higher than that of non-veterans from 1979 through 2003 (the last year covered in the study), at which time it was 13.7 percent (including both unincorporated and incorporated self-employment).[7]
- Veterans with service-connected disabilities are self-employed at lower rates than veterans without such disabilities, when all veterans, including those not in the active labor force, are included in the calculation. Most of this rate differential is attributable to service-disabled veterans not working because of their disabilities.[8]
- Computer use is correlated with higher self-employment rates among all veterans.[9]

Other Advocacy-sponsored research found that both the number and dollar amount of federal contracts to small businesses owned by veterans were understated in the official government reporting system during the study

3 Waldman Associates, 2004; *Entrepreneurship and Business Ownership in the Veteran Population*; report and research summary at http://www.sba.gov/advo/research/rs242tot.pdf.

4 Ibid.

5 Ibid.

6 Ibid.

7 Fairlie, Robert W., 2004; *Self-Employed Business Ownership Rates in the United States: 1979-2003*; report and research summary at http://www.sba.gov/advo/research/rs243tot.pdf.

8 Open Blue Solutions, 2007; *Self-Employment in the Veteran and Service-Disabled Veteran Population*; report and research summary at http://www.sba.gov/advo/research/rs291tot.pdf.

9 Ibid.

period,[10] and that better efforts were needed to improve the quality of data on veteran-owned firms, both to capture unidentified veteran ownership status and to ensure the accuracy of the veteran status markers in existing data sources.[11] This research also recommended that surveys conducted by both government agencies and private sector organizations should include identifiers for veteran status and service-disabled veteran status in their survey instruments.[12]

The complete reports on the research projects, their accompanying summaries, and earlier Advocacy-sponsored research on veteran entrepreneurship issues can be accessed at http://www.sba.gov/advo/research/veterans.html.

New Data on Veterans in Business from the Census Bureau

In July 2007, Census released two new reports on veterans in business, based on data collected in the agency's 2002 Survey of Business Owners and Self-Employed Persons (SBO), part of the Economic Census conducted every five years.[13] Two new reports, *Characteristics of Veteran-Owned Businesses* (CVOB) and *Characteristics of Veteran Business Owners* (CVBO), contain the most important new data from Census on veterans in business since an earlier report based on 1992 data. The scope of the new reports is also much broader than that of the 1992 report, representing the most detailed information on veterans in business ever released by Census.[14]

This chapter relies largely on data from the Census Bureau's new veterans reports based on the 2002 SBO. The SBO included questions on veteran status and on whether responding veteran business owners had a service-connected disability. Data in the veterans reports is generally presented in terms

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10 Eagle Eye Publishers Inc., 2004; *Characteristics of Federal Government Procurement Spending With Veteran-Owned Businesses*: *FY 2000 – FY 2003* (3Q); report and research summary at http://www.sba.gov/advo/research/rs239tot.pdf.

11 Office of Advocacy, 2004; *Evaluating Veteran Business Owner Data*; report and research summary at http://www.sba.gov/advo/research/rs244tot.pdf.

12 Ibid.

13 The SBO is a quinquennial survey first conducted in its present form in 2002. The SBO incorporates many of the purposes and survey questions of three predecessor surveys: the Survey of Minority–Owned Business Enterprises (SMOBE), the Survey of Women-Owned Business Enterprises (SWOBE), and the 1992 Characteristics of Business Owners (CBO) survey. The SMOBE/SWOBE surveys continued in 1997, while the CBO was discontinued after 1992.

14 The new reports, together with accompanying summaries, press releases, and charts are all available at http://www.census.gov/csd/sbo/veteran2002.htm.

of numbers of respondents and the percentages that various cohorts represent among all respondent firms or owners. To be counted as a respondent, the survey recipient had to answer certain key questions, including those on gender, ethnicity, race, and in the case of the CVOB and CVBO reports, the question relating to veteran status.[15]

Not all survey recipients answered these key questions, and the numbers reported in the new reports have not been adjusted upward to account for nonrespondents to the required key questions. Accordingly, the reported numbers of both respondent veteran business owners and respondent veteran-owned firms do not represent the total numbers of such owners or firms in the United States, respondents and nonrespondents alike, but are understated by some factor attributable to nonrespondents.[16]

Because the numbers of reported respondent veteran owners and veteran-owned firms understate the total numbers of these individuals and firms in the U.S. economy, most of the analysis here will use the reported percentages of the various cohorts within the total respondent populations. This follows the practice of the Census Bureau itself in the summary documents provided with the release of the new veterans reports. These percentages could be used in conjunction with other known data on small businesses to develop estimates of the actual numbers of veteran-owned firms; however, as this edition of *The Small Business Economy* was being finalized, statistical procedures had not been conducted to determine whether nonrespondents would have the same characteristics as actual respondents. Accordingly, nonresponse bias remains a possibility whenever extrapolations or generalizations are made about all veteran business owners or veteran-owned firms, beyond those characterized as respondents in the CVOB and CVBO (e.g., by applying the reported veteran percentages to other data sources).

15 Additional technical information on the SBO instruments and methodology is available at http://www.census.gov/econ/census02/text/sbo/cbomethodology.htm.

16 For example, the 2002 SBO estimate of "all respondent firms" in which the business "returned the survey and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly owned" (the condition required to be included in the data tabulations) was 16,687,539. However, in other widely used Census reports, the agency estimated that there were 5.698 million employer firms in 2002 (http://www.census.gov/epcd/susb/2002/us/US--.HTM) and that there were 17.646 million nonemployer firms (http://www.census.gov/epcd/nonemployer/2002/us/US000.HTM) in the same year, resulting in a total of 23.344 million firms. The total number of U.S. firms appears to exceed the "all respondent firm" estimate by a factor of about 1.4 (23.344 / 16.688). Similarly, approximately 2.1 percent of respondents to the gender/ethnicity/race questions did not report on their veteran status, and about 6.0 percent of veteran respondents did not answer the disability question, thus further reducing the pool of those responding to all key questions.

Before moving to the new SBO data, a few remarks on the general veteran population during the survey year of 2002 are in order. In 2002, the 25.6 million veterans in the United States accounted for 12.4 percent of the resident population aged 20 and over.[17]

In 2002, 93.5 percent of all veterans were men,[18] and 81.7 percent were White non-Hispanics.[19] Veterans tend to be older. In 2002, 47.3 percent of all veterans were 60 years old and over (Table 5.1).[20] This age distribution was primarily attributable to the large cohorts from the World War II and Korean conflict eras. In the same year, almost 9.4 percent of all veterans were disabled and receiving compensation.[21] In 2003, 9.5 percent of all the employed people in the United States were veterans, and veterans were less likely to be unemployed.[22]

Analysis of Veteran Business Owners and Veteran-owned Businesses

The following analysis is based on data for an estimated 3 million U.S. military veterans who held business ownership interests in the firms that responded to the 2002 SBO, as reported in the SBO report *Characteristics of Veteran Business Owners* (CVBO) (Table 5.2). These veteran owners represent about 14.5 percent of an estimated 20.5 million total respondent business owners. The CVBO's accompanying report, *Characteristics of Veteran-Owned Businesses* (CVOB), includes data on an estimated 2 million firms with one or more veterans as majority interest owners. These veteran-owned firms represent more than 12.2 percent of the estimated 16.7 million total SBO respondent firms.

The 2002 SBO estimated that there were 812,000 veterans with ownership interests in respondent firms having paid employees (employers), and

17 U.S. Census Bureau, *2003 Statistical Abstract of the United States*, Tables 11 and 530, both accessible at http://www.census.gov/prod/www/statistical-abstract-2001_2005.html.

18 Ibid.

19 U.S. Department of Veterans Affairs, VetPop2004 Version 1.0, Table 5L: Veterans 2000-2033 by Race/Ethnicity, Gender, Period, Age; http://www1.va.gov/vetdata/docs/VP2004B.htm.

20 Op. cit., Note 17, Table 530.

21 Ibid., Tables 530 and 531.

22 Bureau of Labor Statistics, 2003 biennial Veterans Supplement to the Current Population Survey. See http://www.bls.gov/news.release/archives/vet_07272004.pdf.

Table 5.1 Veterans (Living) by Sex, Age, Disability Status, and Period of Service, 2002 (thousands)

	Total veterans	Wartime veterans						Peacetime veterans
		Total [1]	Persian Gulf War	Vietnam era	Korean conflict	World War II		
Total veterans	25,618	19,157	3,573	8,293	3,733	4,762		6,461
Sex								
Male	23,963	18,073	3,017	8,027	3,646	4,552		5,890
Female	1,655	1,084	556	266	87	210		571
Age								
Under 35	2,213	2,050	2,050	— [2]	—	—		163
35-39	1,457	568	568	—	—	—		889
40-44	1,833	369	368	—	—	—		1,465
45-49	2,029	1,210	285	1,016	—	—		819
50-54	2,637	2,517	198	2,474	—	—		120
55-59	3,321	3,105	80	3,096	—	—		217
60-64	2,344	1,094	21	1,072	22	—		1,249
65 and over	9,784	8,245	5	636	3,710	—		1,539
Disabled [3]	2,398	1,823 [4]	419	799	165	440		575

[1]Veterans who served in more than one wartime period are counted only once in total.
[2]Represents or rounds to zero.
[3]Receiving compensation.
[4]Excludes world World I and previous service which have fewer than 500 veterans.
Source: U.S. Census Bureau Statistical Abstract of the United States, 2003, Tables 530 and 531, using data from the Department of Veterans Affairs. See http://www.census.gov/prod/2004pubs/03statab/defense.pdf.

2.2 million veterans with ownership interests in respondent firms with no paid employees (nonemployers) (Table 5.2).[23] Almost 194,000, or about 6.5 percent, of veteran business owners of respondent firms were disabled from injuries or illnesses incurred during active military service. Veterans (disabled and nondisabled) represent majority interest owners (i.e., own at least 51 percent of the stock or equity in the business) in about two-thirds of all respondent businesses. They are equal interest owners in about one-quarter of all respondent businesses. Table 5.3 sets forth detail on interest ownership among all owners of respondent firms.

23 Firms were asked to report information about characteristics of up to three individuals with the largest share of ownership; additional owners were not surveyed about their characteristics. These data were first reported in another SBO report, *Characteristics of Business Owners* released in September, 2006; p. 25, Table 4. See http://www.census.gov/prod/ec02/sb0200cscbo.pdf.

Table 5.2 Veteran Business Ownership by Gender, Hispanic or Latino Origin, and Race for Owners of Respondent Firms, 2002 (percent, except as noted)			
	Owners of respondent firms	Owners of employer respondent firms	Owners of nonemployer respondent firms
Veteran owners (number)	2,973,246	811,740	2,161,506
	100.0	27.3	72.7
Gender			
Male	97.3	98.3	97.0
Female	2.7	1.7	3.0
Ethnicity			
Hispanic	2.3	2.1	2.4
Non-Hispanic	97.7	97.9	97.6
Race			
White	95.5	97.3	94.9
Black	3.2	1.5	3.8
American Indian and Alaska Native	1.0	0.6	1.2
Asian	0.9	1.0	0.9
Native Hawaiian/ Other Pacific Islander	0.1	0.1	0.1

Note: All estimates are based on owners of firms that responded to the SBO, both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s). Detail may not add to total because an Hispanic or Latino firm owner may be of any race. Moreover, each owner had the option of selecting more than one race and therefore is included in each race selected. Percentages represent the percentage of owners of firms in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran Business Owners*, Summary Table A. See http://www.census.gov/csd/sbo/vetownsummaryoffindingsTable_A.pdf.

Characteristics of Veteran Business Owners

Gender, Ethnicity, and Race

The Census report includes data on the gender, ethnicity, and race characteristics of all interest owners of SBO respondent firms (Table 5.4).[24] Veteran owners of respondent firms are overwhelmingly male (97.3 percent), non-Hispanic (97.7 percent) and White (95.5 percent). Black veteran firm owners represent 3.2 percent of all owners; 2.3 percent are Hispanic; 1.0 percent

24 A respondent firm is defined as a business that returned the survey form and provided gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated the firm was publicly held. Unless indicated, all references to firms or businesses in this section are to "respondent firms or businesses."

Table 5.3 Owners of Respondent Firms by Owner's Veteran Status and Business Interest, 2002 (percent except as noted)

	Owners of respondent firms	Owners of respondent firms with employees	Owners of respondent nonemployer firms
All owners (number)	20,526,725	5,574,044	14,954,681
Majority interest owners	64.1	48.6	69.9
Equal interest owners	27.4	29.1	26.7
Nonmajority interest owners	8.6	22.3	3.4
Veteran owners (number)	2,973,246	811,740	2,161,506
Majority interest owners	66.2	55.9	70.1
Equal interest owners	26.8	25.8	27.1
Nonmajority interest owners	7.1	18.3	2.8
Service-disabled veteran (number)	193,750	37,521	156,229
Majority interest owners	68.8	59.2	71.1
Equal interest owners	26.5	27.1	26.3
Nonmajority interest owners	4.7	13.7	2.6
Non service-disabled veteran (number)	2,600,043	724,445	1,875,598
Majority interest owners	65.8	55.5	69.8
Equal interest owners	26.9	25.8	27.3
Nonmajority interest owners	7.3	18.7	2.9
Nonveteran (number)	17,114,631	4,566,839	12,547,792
Majority interest owners	64.1	47.7	70.1
Equal interest owners	27.3	29.6	26.5
Nonmajority interest owners	8.6	22.7	3.4

See http://www.census.gov/prod/ec02/sb0200cscbo.pdf. Note: All estimates are based on owners of firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s). No detail is provided on respondents who did not report veteran or disability status. Percentage columns represent the percentage of owners of firms in the designated categories.
Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Business Owners*; p. 25, Table 4.

Table 5.4 Business Ownership by Veteran Status, Gender, Hispanic Origin, and Race for Owners of Respondent Firms, 2002 (percent)

	Owners of respondent firms			Owners of respondent firms with employees			Owners of respondent firms without employees		
Owner characteristics	All	Veteran	Nonveteran	All	Veteran	Nonveteran	All	Veteran	Nonveteran
Gender									
Male	64.5	97.3	58.8	73.0	98.3	68.5	61.3	97.0	55.2
Female	35.5	2.7	41.2	27.0	1.7	31.5	38.7	3.0	44.8
Ethnicity									
Hispanic	5.3	2.3	5.8	3.8	2.1	4.1	5.9	2.4	6.5
Non-Hispanic	94.7	97.7	94.2	96.2	97.9	95.9	94.1	97.6	93.5
Race									
White	91.7	95.5	91.0	92.6	97.3	91.8	91.3	94.9	90.8
Black	3.5	3.2	3.5	1.5	1.5	1.5	4.2	3.8	4.3
American Indian and Alaska Native	0.8	1.0	0.8	0.5	0.6	0.5	1.0	1.2	0.9
Asian	4.6	0.9	5.3	5.7	1.0	6.6	4.2	0.9	4.8
Native Hawaiian and Other Pacific Islander	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1

Note: All estimates are based on owners of firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s). Detail may not add to total because an Hispanic or Latino firm owner may be of any race. Moreover, each owner had the option of selecting more than one race and therefore is included in each race selected. Percentages represent the percentage of owners of firms in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran Business Owners*; pp. 1-3, Table 1. See http://www.census.gov/csd/sbo/sb0200csveteranown.pdf.

are American Indians or Alaska Natives; and less than one percent are either Asians, Native Hawaiians, or other Pacific Islanders.

Age

Veteran and service-disabled veteran business owners responding to the 2002 SBO tended to be older than all business owners (Table 5.5). In 2002, 67.8 percent of the veteran business owners were age 55 and over, with 35.7 percent between the ages of 55 and 64, and 32.1 percent age 65 and older. Among service-disabled veteran business owners, 57.2 percent were age 55 and over, with 30.7 percent ages 55 through 64, and 26.5 percent age 65 years old and over. In contrast, 30.9 percent of all business owners were age 55 and over, with 20.0 percent of these owners between the ages of 55 and 64, and 10.9 percent age 65 and over.

Education

Veterans tend to be better educated than other business owners (Table 5.6). In 2002, veteran firm owners were about as likely as all owners of respondent firms to have either bachelor or postgraduate degrees (40.7 percent of veterans compared with 40.1 percent of all). But they were more likely to have postgraduate degrees (19.2 percent and 17.3 percent, respectively) and less likely not to have graduated from high school (4.3 percent and 6 percent, respectively).

A specific comparison of veteran, service-disabled veteran, and all business owners by education level finds that in 2002, 67.8 percent of the veteran owners of respondent firms had at least some college education at the time they started or acquired ownership in their business. Over 21 percent had some college but no degree; 5.9 percent had an associate's degree; 21.5 percent had a bachelor's degree; and 19.2 percent had a master's, doctorate, or professional degree.

Among service-disabled veteran owners of respondent firms, 69.7 percent had at least some college education. Over 25 percent had some college but not a degree; 8.5 percent had an associate's degree; 17.9 percent had a bachelor's degree; and 18.2 percent had a master's, doctorate, or professional degree.

In contrast, only 63.9 percent of all owners of respondent businesses had at least some college education. Over 18 percent had some college or no college degree; 5.6 percent had an associate's degree; 22.8 percent had a bachelor's degree; and 17.3 percent had a master's, doctorate, or professional degree.

Table 5.5 Business Ownership by All Owners, Veteran Owners, and Service-Disabled Veteran Owners of Respondent Firms by Owner's Age, 2002 (percent)

	Owners of all respondent firms			Owners of respondent firms with employees			Owners of respondent firms without employees		
Owner's age	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran
Under 25	2.2	0.2	0.4	0.5	-	0.2	2.8	0.2	0.4
25 to 34	11.6	2.9	5.1	7.5	1.6	3.0	13.1	3.4	5.6
35 to 44	23.9	8.0	10.6	24.7	6.8	9.3	23.6	8.4	10.9
45 to 54	28.6	19.7	25.0	32.4	20.6	25.5	27.1	19.3	24.9
55 to 64	20.0	35.7	30.7	21.8	40.2	35.3	19.4	34.0	29.6
65 or over	10.9	32.1	26.5	10.2	29.3	25.1	11.1	33.1	26.8
Item not reported	2.8	1.5	1.7	2.8	1.3	1.5	2.8	1.5	1.7

Note: All estimates are based on owners of firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s). Percentages represent the percentage of owners of firms in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran Business Owners*; p. 4, Table 2. See http://www.census.gov/csd/sbo/sb0200csveteranown.pdf.

Table 5.6 Business Ownership by All Owners, Veteran Owners, and Service-Disabled Veteran Owners of Respondent Firms by Owner's Educational Background, 2002 (percent)

	Owners of respondent firms			Owners of respondent firms with employees			Owners of respondent firms without employees		
Owner's education	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran
Less than high school graduate	6.0	4.3	4.3	3.8	3.2	4.2	6.9	4.7	4.4
High school graduate, diploma or GED	21.2	20.8	18.5	20.5	19.5	16.2	21.4	21.3	19.0
Technical, trade, or vocational school	7.1	6.4	7.1	6.0	5.7	6.8	7.5	6.6	7.1
Some college, but no degree	18.2	21.2	25.1	17.2	19.5	21.9	18.6	21.8	25.9
Associate's degree	5.6	5.9	8.5	5.0	5.1	7.0	5.8	6.3	8.8
Bachelor's degree	22.8	21.5	17.9	24.7	23.1	19.9	22	20.9	17.4
Master's, doctorate or professional degree	17.3	19.2	18.2	20.5	23.2	23.4	16.2	17.7	16.9
Item not reported	1.7	0.7	0.4	2.2	0.7	0.7	1.5	0.7	0.4

Note: All estimates are based on owners of firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s). Percentages represent the percentage of owners of firms in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran Business Owners*; p. 5, Table 3. See http://www.census.gov/csd/sbo/sb0200csveteranown.pdf.

Hours Worked in Business

More than half (50.8 percent) of the veteran owners of employer respondent firms reported working an average of 41 hours or more per week in 2002 (Table 5.7). Similar percentages were reported for service-disabled veteran owners of employer firms (53.9 percent) and all owners of employer firms (50.5 percent).

Owner's Primary Function in the Business

An estimated 52.1 percent of all owners of respondent companies reported "producing this business's goods/services" as the owner's primary function; 52.8 percent had "managing day-to-day operations" as a primary function (Table 5.8).[25] Corresponding percentages for veteran business owners were 54.4 percent and an identical 54.4 percent, respectively; and for service-disabled veteran firm owners, 56.7 percent and 55.6 percent, respectively.

Primary Source of Income

Respondents reported that the business was the owner's primary source of personal income for 50.9 percent of all owners of respondent firms, 47.5 percent of all veteran owners of respondent firms, and 44.1 percent of all service-disabled veteran owners of respondent firms (Table 5.9). Among owners of employer firms, 69.5 percent of all owners, 69.1 percent of veteran owners, and 66.0 percent of service-disabled veteran owners reported that their business income was their primary source of personal income. Owners of nonemployer firms reported somewhat lower reliance on their business income, with 43.9 percent of all owners, 39.4 percent of veteran owners, and 38.9 percent of service-disabled veteran owners indicating that it was their primary source of personal income.

Characteristics of Veteran-owned Businesses

Turning now from veteran business owners to the firms themselves, the SBO data indicate that businesses owned by veterans are nearly identical to all respondent firms in terms of receipts and the employment size (Figures

25 SBO respondents could assign their owners more than one primary function.

Table 5.7 Business Ownership by All Owners, Veteran Owners, and Service-Disabled Veteran Owners of Respondent Firms by Owner's Average Number of Hours Spent Managing or Working in Business, 2002 (percent)

Owner's average number of hours spent managing or working in the business	Owners of all respondent firms			Owners of respondent firms with employees			Owners of respondent firms without employees		
	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran
None	6.8	6.1	5.9	7.1	6.0	5.3	6.7	6.2	6.1
Less than 20 hours	30.1	31.0	30.4	13.1	13.6	13.2	36.4	37.6	34.5
20 to 39 hours	17.7	18.1	20.0	12.7	14.3	15.0	19.5	19.5	21.2
40 hours	10.8	10.0	8.5	13.8	13.6	10.6	9.7	8.6	7.9
41 to 59 hours	20.1	20.0	18.0	31.0	31.1	27.5	16.0	15.9	15.7
60 hours or more	12.9	13.6	16.2	19.5	19.7	26.4	10.4	11.3	13.7
Item not reported	1.7	1.1	1.0	2.9	1.8	1.9	1.2	0.8	0.8

Note: All estimates are based on owners of firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s). Percentages represent the percentage of owners of firms in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran Business Owners*; p. 6, Table 4. See http://www.census.gov/csd/sbo/sb0200csveteranown.pdf.

Table 5.8 All Owners, Veteran Owners, and Service-Disabled Veteran Owners of Respondent Firms by Owner's Primary Function in Business, 2002 (percent of business ownership)

	Owners of all respondent firms			Owners of respondent firms with employees			Owners of respondent firms without employees		
Owner's primary function in the business	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran
Producing firm's goods/services	52.1	54.4	56.7	46.6	49.6	52.1	54.2	56.2	57.8
Managing day-to-day operations	52.8	54.4	55.6	63.0	64.0	68.1	49.0	50.8	52.6
Financial control with authority to sign loans, leases and contracts	39.5	42.8	41.2	54.1	57.3	59.0	34.1	37.3	37.0
None of the above	17.1	14.7	14.9	10.9	9.1	7.8	19.4	16.8	16.6
Item not reported	1.6	1.0	1.2	1.9	0.8	1.0	1.6	1.1	1.2

Note: All estimates are based on owners of firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s). Percentages represent the percentage of owners of firms in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran Business Owners*; p. 7, Table 5. See http://www.census.gov/csd/sbo/sb0200csveteranown.pdf.

Table 5.9 All Owners, Veteran Owners, and Service-Disabled Veteran Owners of Respondent Firms by Whether Business Provided Owner's Primary Source of Income, 2002 (percent of business ownership)

	Owners of all respondent firms			Owners of respondent firms with employees			Owners of respondent firms without employees		
Owner's primary source of personal income?	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran	All	Veteran	Service-disabled veteran
Yes	50.9	47.5	44.1	69.5	69.1	66.0	43.9	39.4	38.9
No	46.9	51.0	54.1	28.3	30.0	33.0	53.8	59.0	59.2
Item not reported	2.2	1.4	1.7	2.1	0.9	1.0	2.2	1.6	1.9

Note: All estimates are based on owners of firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s). Percentages represent the percentage of owners of firms in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran Business Owners*; p. 8, Table 6. See http://www.census.gov/csd/sbo/sb0200csveteranown.pdf.

5.1 and 5.2).[26] The largest percentage shares of both veteran-owned and all businesses (about 60 percent of firms in each category) were concentrated in the same five business sectors: professional, scientific, and technical services; construction; other services; retail trade; and real estate and rental and leasing (Figure 5.3). Health care and social assistance is also an important business sector for veteran-owned and all businesses.

Despite these similarities, the SBO's *Characteristics of Veteran-Owned Businesses* (CVOB) report did provide insight on a number of important differences between veteran-owned firms and all firms, often related to the older age profile of the veteran community. The balance of this chapter will look at some of the characteristics of these firms.

Age of Veteran-owned Businesses

Overall, veteran-owned businesses are older than all U.S firms generally. In 2002, 54.6 percent of veteran-owned businesses with paid employees and 33.1 percent of veteran-owned businesses without paid employees reported that their businesses were acquired before 1990 (Table 5.10). In contrast, 35.7 percent of all respondent firms with employees and 20.8 percent of firms with no paid employees were in business before 1990.

Compared with all firms, however, smaller percentages of veteran-owned businesses were acquired after 1999. About 8.6 percent of veteran-owned firms with employees and 19.1 percent of veteran-owned firms without employees reported that their businesses were acquired after 1999, compared with 14.6 percent of all firms with employees and 26.6 percent of all firms without employees.

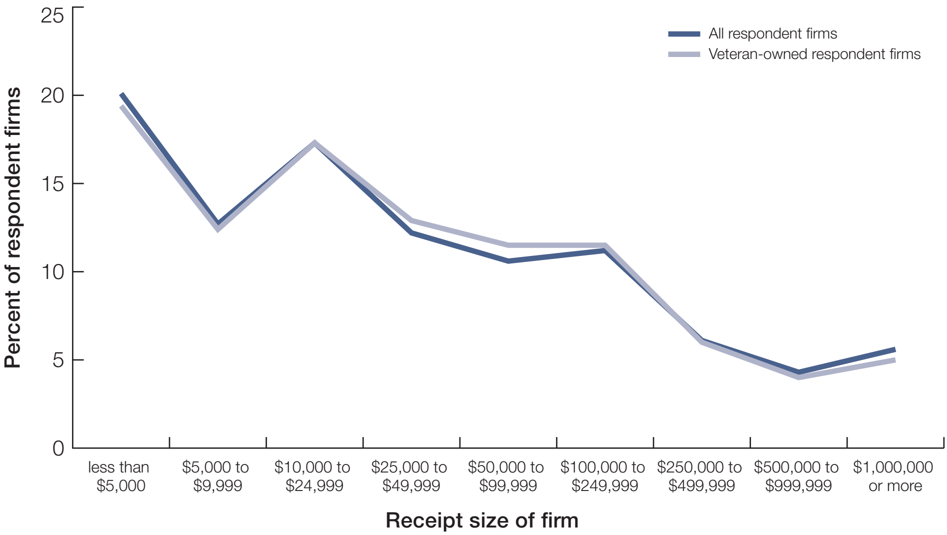
Size of Veteran-owned Businesses by Receipts/Sales

In sales/receipts sizes, veteran-owned and all respondent firms were nearly identical (Table 5.11). This was true for firms both with and without employees. For example, in 2002 about 11 percent of both all firms and all veteran-owned firms had receipts in the range of $100,000-$249,000.

As would be expected, respondent employer firms tended to have greater receipts than firms without employees, and larger shares of employers were

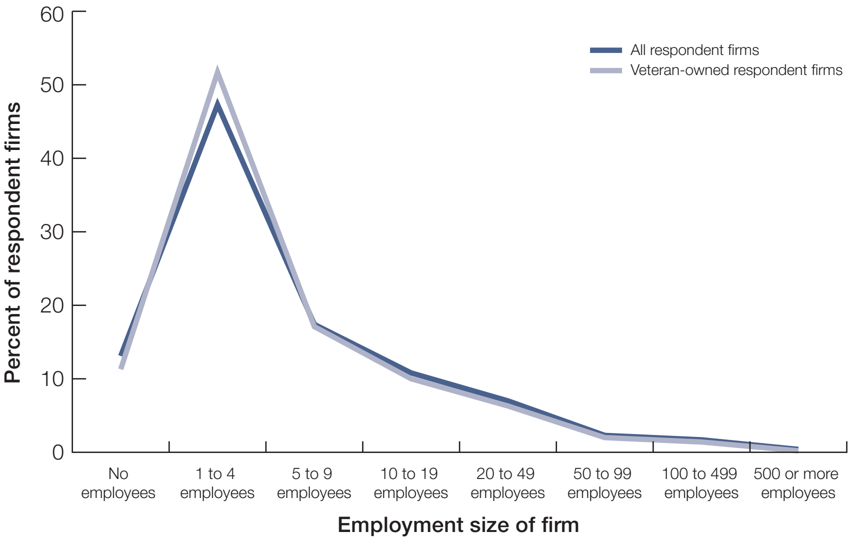
26 These data on veteran-owned firms and veteran owners are only representative of respondent firms (other than publicly held and other firms whose owners' characteristics are indeterminate) that answered the veteran ownership question. No adjustments are made to the data to account for nonresponse to the veteran ownership question.

Figure 5.1 - Percentage Distribution of Respondent Firms by Receipt Size, 2002



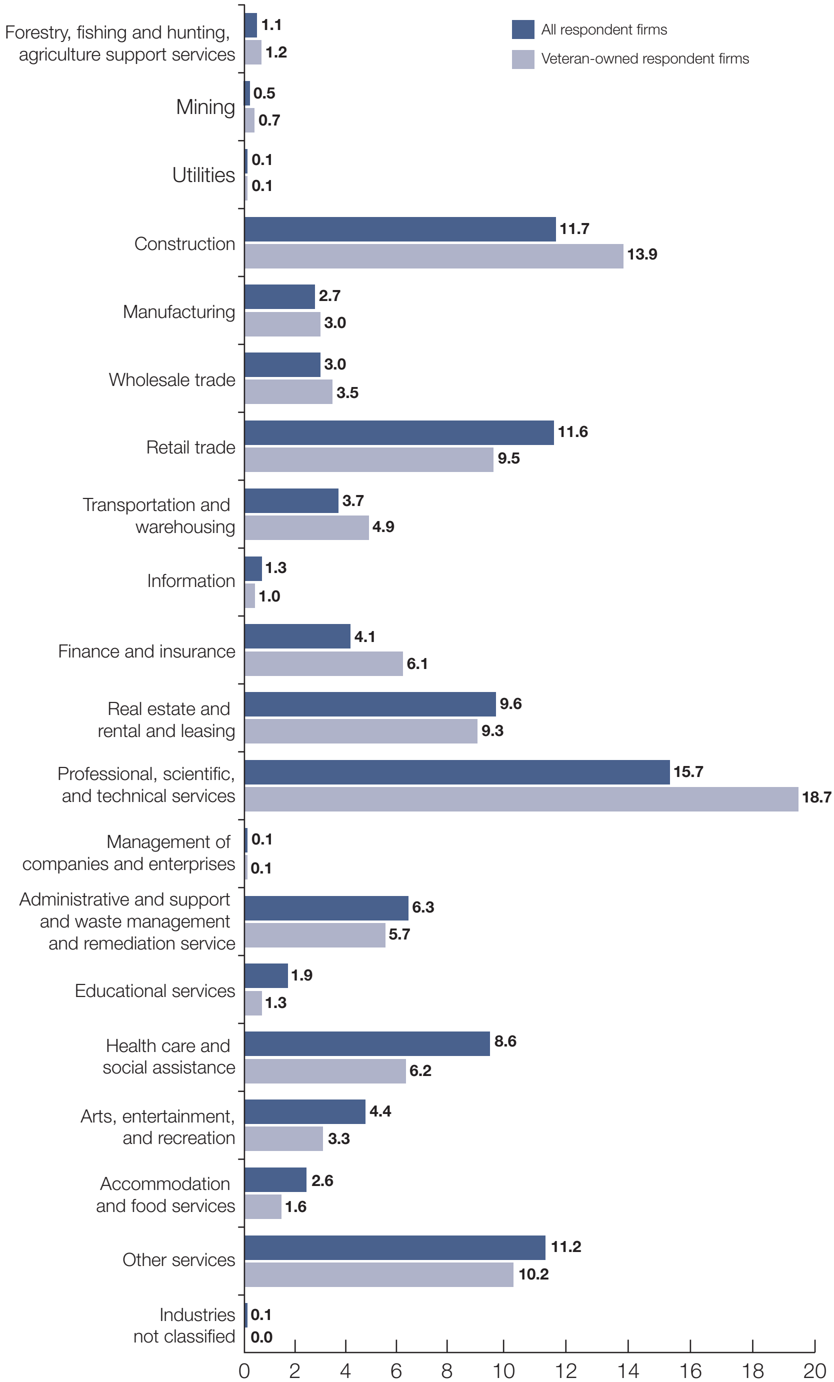
Source: U.S. Census Bureau, 2002 Survey of Business Owners.

Figure 5.2 - Percentage Distribution of Respondent Firms by Employer Size, 2002



Source: U.S. Census Bureau 2002 Survey of Business Owners.

Figure 5.3 - Percentage Distribution of Respondent Firms by Kind of Business, 2002



Source: U.S. Census Bureau, 2002 Survey of Business Owners.

Table 5.10 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners by Year in which Owner(s) Established, Purchased, or Acquired the Business, 2002 (percent)

	Respondent firms		Respondent firms with employees		Respondent firms without employees	
Year business established, purchased, or acquired	All firms	Firms with veteran owners	All firms	Firms with veteran owners	All firms	Firms with veteran owners
Before 1980	10.2	21.3	15.9	32.6	8.4	17.8
1980 to 1989	14.2	16.9	19.8	22.0	12.4	15.3
1990 to 1996	17.7	16.5	20.7	16.7	16.7	16.4
1997	3.8	3.1	4.2	2.8	3.7	3.2
1998	4.2	3.4	4.2	2.8	4.2	3.6
1999	5.1	3.7	4.8	3.1	5.2	3.9
2000	6.4	4.6	5.3	3.2	6.8	5.1
2001	7.2	4.9	5.1	3.0	7.9	5.6
2002	10.1	6.9	4.2	2.4	11.9	8.4
Item not reported	21.1	18.6	15.7	11.6	22.8	20.7

Note: All estimates are based on firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Firms with more than one domestic establishment are counted only once. Percentages represent the percentage of firms reporting in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran-Owned Businesses*; p. 1, Table 1. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

found in the higher receipts size classes. More than 20 percent of both all employer firms and veteran-owned employer firms responding to the SBO had receipts of $1 million or more. The opposite was the case for firms without employees. When employers and nonemployers are taken together, the proportions of all respondent firms and all veteran-owned respondent firms reporting in each receipt size class decreased as the receipt size categories increased.

Size of Veteran-owned Businesses by Number of Employees

Businesses owned by veterans tended to be very similar to all respondent businesses in their employment sizes (Table 5.12). All respondent firms were slightly more likely to have no employees than respondent veteran-owned businesses—13.1 percent and 11.3 percent, respectively.

While more than half (51.7 percent) of all respondent veteran-owned businesses had 4 or fewer employees, 47.3 percent of all respondent firms were in

Table 5.11 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners by Receipt Size of Firm, 2002 (percent)

Sales/receipts size of business	Respondent firms: All firms	Respondent firms: Firms with veteran owners	Respondent firms with employees: All firms	Respondent firms with employees: Firms with veteran owners	Respondent firms without employees: All firms	Respondent firms without employees: Firms with veteran owners
Less than $5,000	20.1	19.4	0.7	0.8	26.4	25.2
$5,000 to $9,999	12.7	12.4	1.0	1.0	16.4	16.0
$10,000 to $24,999	17.3	17.3	3.2	3.4	21.8	21.6
$25,000 to $49,999	12.2	12.9	5.4	5.6	14.4	15.1
$50,000 to $99,999	10.6	11.5	10.9	11.7	10.5	11.4
$100,000 to $249,999	11.2	11.5	23.2	24.0	7.2	7.6
$250,000 to $499,999	6.1	6.0	18.6	18.7	2.1	2.0
$500,000 to $999,999	4.3	4.0	14.6	14.2	1.0	0.8
$1,000,000 or more	5.6	5.0	22.3	20.6	0.2	0.2

Note: All estimates are based on firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Firms with more than one domestic establishment are counted only once. Percentages represent the percentage of firms reporting in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran-Owned Businesses*; pp. 14-20, Table 2. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

this employment size category. More than 99 percent of both all respondent firms and all veteran-owned respondent firms had fewer than 500 employees.

Home-based Veteran-owned Businesses

In 2002, more than half (51.8 percent) of veteran-owned respondent businesses reported that they were operating from the owner's home, compared with 49.4 percent of all respondent businesses (Table 5.13). As expected, veteran-owned businesses without employees were more likely to be home-based than those with employees—60.8 percent and 22.9 percent, respectively. Percentages of home-based veteran-owned firms varied by kind of business, employer status, and size of firm in proportions similar to those of all home-based firms.

The largest proportions of home-based veteran-owned firms by kind of business were in construction (72.6 percent compared with 67.9 percent for

Table 5.12 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners by Employment Size of Firm, 2002 (percent)

	Respondent firms	
Employment size of firm	All firms	Firms with veteran owners
No employees	13.1	11.3
1 to 4 employees	47.3	51.7
5 to 9 employees	17.4	17.1
10 to 19 employees	10.8	10.0
20 to 49 employees	7.0	6.3
50 to 99 employees	2.3	2.0
100 to 499 employees	1.7	1.4
500 or more employees	0.4	0.2

Note: All estimates are based on firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Firms with more than one domestic establishment are counted only once. Percentages represent the percentage of firms reporting in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran-Owned Businesses*; 21-27, Table 3. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

all firms) and administrative / support and waste management / remediation services (63.1 percent compared with 60.0 percent for all firms).[27]

Family-owned Businesses

In 2002, 15.7 percent of veteran-owned respondent businesses reported that they were family-owned (Table 5.13). Another 75.2 percent reported that they had only one owner. This compares with a reported 23.4 percent for family ownership and 63.6 percent for sole owners among all respondent businesses. Although the combined family and sole ownership shares are similar between all firms and veteran-owned firms, the veteran-owned businesses appear to be more heavily weighted toward sole ownership.

Veteran-owned businesses with employees were slightly more likely to be family-owned than their counterparts without employees, 16.9 percent and 15.3 percent, respectively. Among respondent veteran-owned employer firms, 71.3 percent had only one owner compared with 76.4 percent of non-employer veteran-owned businesses.

27 A complete breakout by industry (two-digit NAICS code) for home-based, family-owned, and franchised businesses is available in the SBO's "Characteristics of Veteran-Owned Businesses," Table 4, 28-40. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

Table 5.13 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners that Operated as a Home-Based, Family-owned, or Franchised Business, 2002 (percent)

	Respondent firms		Respondent firms with employees		Respondent firms without employees	
Type of operation	All firms	Firms with veteran owners	All firms	Firms with veteran owners	All firms	Firms with veteran owners
Home-based						
Yes	49.4	51.8	22.1	22.9	58.3	60.8
No	46.5	44.3	74.8	75.1	37.3	34.7
Item not reported	4.1	3.9	3.1	2.0	4.4	4.5
Family-owned						
Yes	23.4	15.7	28.1	16.9	21.9	15.3
No	9.4	6.2	18.3	11.0	6.5	4.7
Only one owner	63.6	75.2	51.0	71.3	67.7	76.4
Item not reported	4.2	3.6	4.1	3.0	4.2	3.8
Franchised						
Yes	1.9	1.6	3.7	3.3	1.4	1.1
No	93.5	94.1	93.1	94.5	93.6	93.9
Item not reported	4.6	4.3	3.3	2.2	5.0	5.0

Note: All estimates are based on firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Firms with more than one domestic establishment are counted only once. Percentages represent the percentage of firms reporting in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran-Owned Businesses*; p. 28, Table 4. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

The largest proportions of family-owned, veteran-owned firms by kind of business were in management of companies and enterprises (27.8 percent compared with 21.0 percent for all firms) and real estate and rental and leasing (25.3 percent compared with 33.2 percent for all firms).[28]

Family-owned businesses constituted 16.9 percent of veteran-owned firms with employees, with a lower incidence of family-owned businesses in the larger employment size categories. Family ownership was reported for 30.4 percent of veteran-owned firms with 50 to 99 employees, 26.5 percent with 100 to 499 employees, and 26.9 percent with 500 or more employees.[29]

28 Ibid.

29 Ibid.

Franchised Veteran-owned Businesses

In 2002, 1.6 percent of veteran-owned respondent businesses were operated as franchises (Table 5.13). The largest proportions of franchised veteran-owned firms by kind of business were in management of companies and enterprises (13.5 percent compared with 8.6 percent for all firms) and in accommodation and food services (12.0 percent compared with 11.8 percent for all firms).

Franchised businesses constituted only 3.3 percent of respondent veteran-owned firms with employees. The incidence of franchised businesses was not necessarily higher for firms in the higher employment size categories. Almost 11 percent (10.7 percent) of veteran-owned firms with 50 to 99 employees, 13.0 percent with 100 to 499 employees, and 8.9 percent with 500 or more employees reported that they were franchises.[30]

Capital Requirements

The share of veteran-owned respondent firms with owners who relied on personal or family assets for capital to start or acquire their firms was nearly the same as that for all respondent businesses (Table 5.14). Of the veteran-owned respondent businesses, 63.9 percent reported using "personal/family savings" and/or "other personal/family assets" as sources of capital to start or acquire the business—basically the same percentage (63.6 percent) reported by all SBO respondent firms.

Use of a personal/business credit card as a source of capital was reported by 7.4 percent of veteran-owned firms and 8.8 percent of all firms.

Percentages of veteran-owned firms and all firms originally financed by banks were also nearly identical (11.5 percent and 11.4 percent, respectively), as were the percentages financed directly by government loans or government-guaranteed bank loans (1.3 percent and 1.6 percent, respectively).

Of respondent veteran-owned businesses, 28.1 percent reported that they did not need capital to start or acquire their businesses. Outside investors provided capital to 2.1 percent of veteran-owned firms compared with 2.7 percent of all firms. Veteran-owned businesses and all businesses also reported comparable access to the capital used to finance expansion or capital improvements.[31]

30 Ibid.

31 Ibid., Table 10, 80.

Table 5.14 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners by Sources of Capital Needed to Start or Acquire the Business, 2002 (percent)						
	Respondent firms		Respondent firms with employees		Respondent firms without employees	
Sources of capital	All firms	Firms with veteran owners	All firms	Firms with veteran owners	All firms	Firms with veteran owners
Personal/family savings	54.6	55.4	64.2	66.8	51.5	51.8
Other family personal assets	9.0	8.5	13.1	12.1	7.7	7.4
Personal/business credit card	8.8	7.4	9.2	7.5	8.6	7.3
Business loan from government	0.9	0.7	1.7	1.3	0.7	0.6
Government-guaranteed bank loan	0.7	0.6	1.7	1.5	0.4	0.3
Business loan from bank	11.4	11.5	22.2	22.9	7.9	8.0
Outside investor	2.7	2.1	4.7	3.5	2.0	1.7
None needed	27.7	28.1	11.8	11.5	32.9	33.3
Item not reported	3.9	3.4	3.7	2.1	4.0	3.8

Note: All estimates are based on firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Firms with more than one domestic establishment are counted only once. Percentages represent the percentage of firms reporting in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran-Owned Businesses*; p. 55, Table 7. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

Types of Customers

Customer types were similar for veteran-owned and all firms (Table 5.15). Veteran-owned and all respondent firms, respectively, reported sales of 10 percent or more to the following customers: household consumers and individuals, 46.1 and 42.9 percent, respectively; other businesses and organizations, 36.0 and 32.0 percent; state and local governments, 6.0 and 5.3 percent; the federal government, 2.6 and 2.0 percent; and exports, 1.3 and 1.4 percent.

Work Force

The types of workers used by veteran-owned firms and all firms responding to the SBO differed only slightly (Table 5.16). Almost 83 percent of both veteran-owned firms and all employer firms reported using their own full- and

Table 5.15 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners by Total Sales of 10 Percent or More to Customer Categories, 2002 (percent)

	Respondent firms		Respondent firms with employees		Respondent firms without employees	
Types of customers	All firms	Firms with veteran owners	All firms	Firms with veteran owners	All firms	Firms with veteran owners
Federal government	2.0	2.6	2.9	3.5	1.7	2.4
State and local government	5.3	6.0	7.7	8.6	4.5	5.2
Export sales	1.4	1.3	1.8	1.6	1.3	1.2
Other businesses/ organizations	32.0	36.0	38.6	42.4	29.9	34.0
Household consumers/ individuals	49.2	46.1	53.8	52.6	47.8	44.1
All others	18.7	20.4	16.4	18.4	19.5	21.0
Item not reported	7.9	6.2	5.0	2.8	8.9	7.3

Note: All estimates are based on firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Firms with more than one domestic establishment are counted only once. Percentages represent the percentage of firms reporting in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran-Owned Businesses*; p. 105, Table 13. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

part-time paid employees to operate the business; 7.3 percent used temporary staff from a temporary help service; and 1.3 percent leased employees from a leasing service or professional employer organization.

Nearly 32 percent of veteran-owned firms with employees compared with 34.1 percent of all firms with employees used contractors, subcontractors, independent contractors or outside consultants; and 5.4 percent compared with 5.8 percent reported using paid day laborers to supplement their work force.

Kind of Business

Veteran-owned firms are generally distributed similarly to all respondent firms in 20 major industries (two-digit North American Industry Classification System or NAICS codes) (Table 5.17). In a few industries, however, they differ.

The percentage of all respondent veteran-owned firms in construction was higher than that of all firms (13.9 percent compared with 11.7 percent). This was also true in transportation and warehousing (4.9 percent compared with

Table 5.16 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners by Types of Workers, 2002 (percent)						
	Respondent firms		Respondent firms with employees		Respondent firms without employees	
Types of workers	All firms	Firms with veteran owners	All firms	Firms with veteran owners	All firms	Firms with veteran owners
Paid employees reported on IRS Form 941	25.2	24.7	82.5	82.5	6.5	6.6
Paid day laborers	4.9	5.0	5.8	5.4	4.6	4.9
Temporary staffing from a temporary help service	2.8	2.8	7.3	7.3	1.3	1.4
Leased employees from a leasing service or professional employer organization	0.9	0.9	1.3	1.3	0.8	0.7
Contractors, subcontractors, independent contractors or outside consultants	22.5	21.9	34.1	31.7	18.7	18.9
Item not reported	3.9	3.2	2.6	1.4	4.4	3.8

Note: All estimates are based on firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Firms with more than one domestic establishment are counted only once. Percentages represent the percentage of firms reporting in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran-Owned Businesses*; p. 127, Table 16. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

3.7 percent); finance and insurance (6.1 percent compared with 4.1 percent); and professional, scientific, and technical services (18.7 percent compared with 15.7 percent).

The share of veteran-owned firms in retail trade was lower than that of all firms (9.5 percent and 11.6 percent, respectively). Veteran-owned firms also had lower shares in health care and social assistance (6.2 percent for veteran-owned firms compared with 8.6 percent for all firms), and in accommodation and food services (1.6 percent compared with 2.6 percent).

These trends generally held true for both firms with employees and firms without employees, except in the case of employer firms in the health care and social assistance industry, where veteran-owned firms had a slightly higher share than all firms (11.6 percent compared with 11.0 percent), which was more than offset by their lower share among nonemployers.

Table 5.17 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners by Kind of Business (two-digit NAICS code), 2002 (percent)

NAICS code: Business sector	Respondent firms		Respondent firms with employees		Respondent firms without employees	
	All firms	Veteran-owned firms	All firms	Veteran-owned firms	All firms	Veteran-owned firms
11: Forestry, fishing and hunting, and agriculture support services (113-115) [1]	1.1	1.2	0.1	0.4	1.2	1.4
21: Mining	0.5	0.7	0.4	0.5	0.5	0.8
22: Utilities	0.1	0.1	0.1	0.1	0.1	0.1
23: Construction	11.7	13.9	13.4	14.4	11.1	13.7
31: Manufacturing	2.7	3.0	5.8	6.5	1.7	1.9
42: Wholesale trade	3.0	3.5	6.0	6.8	2.1	2.5
44: Retail trade	11.6	9.5	13.2	11.7	11.1	8.8
48: Transportation and warehousing [2]	3.7	4.9	2.9	3.2	3.9	5.4
51: Information	1.3	1.0	1.3	0.9	1.4	1.0
52: Finance and insurance [3]	4.1	6.1	4.6	6.2	4.0	6.0
53: Real estate and rental and leasing	9.6	9.3	4.8	5.1	11.2	10.7
54: Professional, scientific, and technical services	15.7	18.7	14.2	16.3	16.2	19.4
55: Management of companies and enterprises	0.1	0.1	0.6	0.4	0.0	0.0
56: Administrative and support and waste management/ remediation service	6.3	5.7	5.4	4.8	6.6	5.9
61: Educational services	1.9	1.3	1.2	0.5	2.2	1.5
62: Health care and social assistance	8.6	6.2	11.0	11.6	7.9	4.6
71: Arts, entertainment, and recreation	4.4	3.3	1.9	1.1	5.2	4.0

Table 5.17 All Respondent Firms and Respondent Firms With One or More Veterans as Majority Interest Owners by Kind of Business (two-digit NAICS code), 2002 (percent) —continued

	Respondent firms		Respondent firms with employees		Respondent firms without employees	
NAICS code: Business sector	All firms	Veteran-owned firms	All firms	Veteran-owned firms	All firms	Veteran-owned firms
72: Accommodation and food services	2.6	1.6	6.9	4.0	1.2	0.8
81: Other services (except public administration)[4]	11.2	10.2	7.0	6.4	12.6	11.4
99: Industries not classified	0.1	0.0	0.2	0.2	0.0	0.0

1 Data do not include crop and animal production (NAICS 111 and 112)
2 Data do not include large certificated carriers, railroad transportation and the U.S. Postal Service.
3 Data do not include funds, trusts, and other financial vehicles (NAICS 525) except real estate investment trusts (525930)
4 Data do not include religious, grantmaking, civic, professional, and similar organizations (NAICS 813) or private households
Note: All estimates are based on firms that responded to the 2002 Survey of Business Owners (SBO), both firms with paid employees and firms with no paid employees. A respondent firm is defined as a business that returned the survey form and provided the gender, Hispanic or Latino origin, or race characteristics for the owner(s) or indicated that the firm was publicly held. Firms with more than one domestic establishment are counted only once. Percentages represent the percentage of firms reporting in the designated categories.

Source: U.S. Census Bureau, 2002 Survey of Business Owners (SBO), *Characteristics of Veteran-Owned Businesses*; pp. 1-13, Table 1. See http://www.census.gov/csd/sbo/sb0200csveteranbus.pdf.

Conclusion

The Census Bureau's current SBO provides the most detailed data on veterans and service-disabled veterans in business ever collected. The preceding analyses have summarized two much larger reports which are available on line at http://www.census.gov/csd/sbo/veteran2002.htm, and readers are urged to refer to those reports for additional information.

In addition to these readily accessible reports, the SBO produced a very rich dataset which can be used by researchers with questions not addressed in the published documents. Any number of queries can be formulated using data elements included in the SBO's survey instruments and other administrative data. For additional information on how to use SBO data and special tabulations, consult "How to Obtain Special Tabulations" at http://www.census.gov/csd/sbo/.

The SBO results provided here are based on samples and administrative data from 2002. As this report was being finalized, preparations were under way for the 2007 SBO. It is hoped that data collected in this important new survey can be used in comparison with the 2002 data already in hand to identify differences in veteran business ownership factors over the five-year period.

The Office of Advocacy is continuing its veteran business ownership research program, and several projects are currently under way. These include in-house and specialized contract research projects, efforts to include veteran-related data in as many research reports as possible, and collaborative work with other agencies to use administrative data to learn more about businesses owned by veterans and service-disabled veterans, thereby adding value to existing government resources. The results of this new research will be reported as they become available.

6 Social Entrepreneurship *and* Government: A New Breed *of* Entrepreneurs Developing Solutions *to* Social Problems

Synopsis

Social entrepreneurship—the practice of responding to market failures with transformative, financially sustainable innovations aimed at solving social problems—has emerged at the nexus of the public, private, and nonprofit sectors.[1] It is a new breed of entrepreneurship that exhibits characteristics of nonprofits, government, and businesses—including applying to social problem-solving traditional, private-sector entrepreneurship's focus on innovation, risk-taking, and large-scale transformation. While social entrepreneurship is not a new phenomenon, the field has experienced enormous growth over the past 15 years, receiving increasing recognition from journalists, philanthropists, researchers, and policymakers as an important and distinctive part of the nation's social, economic, and political landscape.

This chapter introduces city, state, and federal government officials to social entrepreneurship. Given the traditional role of the government in responding to market failures—and the $1 trillion plus per year of federal funds dedicated to resolving domestic social problems[2]—the author argues that there is a yet-to-be-harnessed opportunity for government leaders and social entrepreneurs to collaborate to leverage public and private resources and generate transformative, cost-effective solutions to the most challenging social problems facing the nation and world. Incorporating insights from experts in the field of social entrepreneurship and case studies examining eight success-

1 This chapter was prepared under contract with the U.S. Small Business Administration, Office of Advocacy, by Andrew M. Wolk, Root Cause/ Massachusetts Institute of Technology. The project was managed by Marie Zemler Wu, senior editor, with special thanks to Kelley Kreitz and Andrea E. McGrath. The views presented here are those of the authors and not of the U.S. Small Business Administration or the Office of Advocacy.

2 U.S. Bureau of the Census, *Consolidated Federal Funds Report for Fiscal Year 2004*. This figure is based on federal spending in 2004 on direct benefits, service grants and contracts, and government agency staff. This does not include the additional funds raised and spent at the state and local levels, nor does it include money spent on foreign assistance.

ful social-entrepreneurial initiatives, the chapter answers the following three questions: (1) What is social entrepreneurship? (2) How does social entrepreneurship help government benefit Americans? (3) How is government currently supporting social-entrepreneurial initiatives?

Some may ask, "What does social entrepreneurship have to do with small business?" A short answer might be that social entrepreneurship exhibits many of the attributes of small business entrepreneurship, serving as an engine of innovation, job creation, and economic growth. Moreover, by bringing together aspects of the public, private, and nonprofit sectors to address a market failure, social entrepreneurs have, in a variety of ways, helped create an economic environment in which private entrepreneurs and small businesses can flourish. The longer answer may be to read on and see how this chapter answers the question.

Introduction: Social Entrepreneurship Enters the Public Eye

In his 2007 State of the Union address, President George W. Bush acknowledged an individual who represents an emerging field with a growing significance for policymakers. Among his honored guests at the U.S. Capitol was Julie Aigner-Clark, founder of the profitable children's video company, Baby Einstein, and current producer of child safety videos with the National Center for Missing and Exploited Children. The president praised her by saying: "Julie represents the great enterprising spirit of America. And she is using her success to help others…we are pleased to welcome this talented business entrepreneur and generous social entrepreneur."[3]

That the president of the United States honored a "social entrepreneur" in his State of the Union address exemplifies the growing recognition that social entrepreneurship—the practice of responding to market failures with transformative, financially sustainable innovations aimed at solving social problems[4]—has received in recent years. The field constitutes a new breed

3 Bush, *State of the Union 2007,* http://www.whitehouse.gov/news/releases/2007/01/20070123-2.html.

4 This working definition of social entrepreneurship will be discussed in more detail and illustrated with examples, in the sections that follow. Market failure occurs when the cost of a good or service is higher than the price that individuals are willing or able to pay, yet the social benefits from that good or service make its availability worthwhile for maintaining a healthy, productive society, (Gruber, *Public Finance and Public Policy*).

of entrepreneurship that exhibits characteristics of nonprofits, government, and businesses—including applying to social problem solving traditional, private-sector entrepreneurship's focus on innovation, risk-taking, and large-scale transformation.[5] This new movement has come into the limelight in a number of ways in recent years:

In 2006, Teach For America Founder Wendy Kopp and City Year Co-Founders Michael Brown and Alan Khazei were profiled among *U.S. News and World Report*'s Top 25 Leaders. Muhammad Yunus and his organization, the Grameen Bank, were awarded a Nobel Peace Prize. Victoria Hale of the Institute for OneWorld Health and Jim Fructerman of Benetech received "genius awards" from the MacArthur Foundation. All identify themselves as social entrepreneurs.[6]

In 2005, the Public Broadcasting System (PBS) and the Skoll Foundation created and aired a two-part miniseries profiling *The New Heroes*, 14 social entrepreneurs from around the globe. They followed the series with a three-year grant program encouraging filmmakers, documentary filmmakers, and journalists to "produce work that promotes large-scale public awareness of social entrepreneurship."[7]

For the past six years, the World Economic Forum, which annually brings together business, government, and national leaders who are "committed to improving the state of the world," has hosted a Social Entrepreneurs' Summit. In partnership with the Schwab Foundation, the forum convenes social entrepreneurs as one of its special-interest communities, placing social entrepreneurship on par with only nine other interest groups, including global growth companies, international media, and labor leaders.[8]

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5 Early twentieth-century economist Joseph Schumpeter is largely responsible for this conception of entrepreneurship. He argued that, "the function of entrepreneurs is to reform or revolutionize the pattern of production by exploiting an invention," (Schumpeter, *The Theory of Economic Development*). For a detailed discussion of the history of entrepreneurship and its relationship to social entrepreneurship, see Dees, "The Meaning of 'Social Entrepreneurship.'"

6 This article uses the term "social entrepreneur" to mean a person or small group of individuals who founds and/or leads an organization or initiative engaged in social entrepreneurship. While those cited here identify themselves as social entrepreneurs, the term is applied throughout the article to any individual who fits this definition regardless of whether they would use it to characterize themselves. Social entrepreneurs are also sometimes called "public entrepreneurs," "civic entrepreneurs," or "social innovators."

7 Skoll Foundation, "PBS Foundation and Skoll Foundation Establish Fund to Produce Unique Programming About Social Entrepreneurship," http://www.skollfoundation.org/media/press_releases/internal/092006.asp.

8 Schwab Foundation for Social Entrepreneurship, *Summit Report*, http://schwabfound.org/the.htm?p=102.

Popular media have brought the term social entrepreneurship greater household recognition. *The New York Times*, *The Economist*, and the *Harvard Business Review* have all printed stories focused on social entrepreneurship.[9]

As social entrepreneurship is rapidly finding its way into the vocabulary of policymakers, journalists, academics, and the general public, the United States is facing incredible societal challenges and needs. One in eight Americans, including one in four African Americans, lives in poverty.[10] One-quarter of adults fail to finish high school, creating a national graduation rate that lags 8 percent behind rates in the European Union.[11] Despite the highest per capita spending on health care,[12] the U.S. health system is ranked number 37 in the world—lower than any other developed nation.[13] On any given day, one out of every 108 American men is incarcerated.[14]

The boom of the field of social entrepreneurship, and its promise as a means of addressing the daunting social problems that America currently faces, are of particular importance for policymakers. By far, the largest sources of services and funding to help solve these problems are federal, state, and local governments. In the domestic budget alone, the federal government spends more than $1 trillion each year providing direct benefits to constituents, awarding service grants and contracts, and employing government agency staff.[15] State and local governments raise and spend their own funds to benefit their constituents—creating an even larger pool of governmental spending and activities to solve social problems.

Government funding dwarfs the amount spent by the nation's largest foundations, which together donate $16.4 billion annually to nonprofits,[16]

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9 Finder, "A Subject for Those Who Want to Make a Difference," *New York Times*; Bishop, "The Rise of the Social Entrepreneur," *The Economist*, 11-13; and Dees, "Enterprising Nonprofits," *Harvard Business Review,* 54-67.

10 DeNavas-Walt et al., *Income, Poverty, and Health Insurance*, 13.

11 Organization for Economic Co-Operation and Development, *Education at a Glance.*

12 California HealthCare Foundation, *Snapshot: Health Care Costs 101*.

13 World Health Organization, "The World Health Organization Assesses the World's Health Systems," http://www.who.int/whr/2000/media_centre/press_release/en/index.html.

14 Harrison and Beck, *Bureau of Justice Statistics Bulletin*, 4

15 U.S. Bureau of the Census, *Consolidated Federal Funds Report*, 5.

16 Foundation Center, *Foundation Giving Trends*, 2. This figure includes grants of $10,000 or more, made by the nation's 1,154 largest foundations during calendar year 2005. Research has shown this type of calculation generally represents half of all foundation giving, if smaller grants and/or foundations were to be included.

as well as the giving by individuals, who donate $163.5 billion each year to social causes.[17] Of the nation's 144 largest and fastest-growing nonprofits—all of which have $50 million or more in annual revenue—more than 40 percent rely on government as their primary funding source. The next most common funding comes from service fees, which are paid at least in part by government agencies in 90 percent of cases.[18]

Given both the magnitude of needs and the scope of spending, government leaders constantly face tough decisions about how to improve the lives of their constituents while most effectively using tax dollars. As elected officials and government agency staff approach these tough choices, social entrepreneurs offer a new source of assistance. Government leaders and social entrepreneurs share an interest in identifying efficient, effective, and sustainable ways to solve difficult social problems. Despite this common goal, however, little has been published by scholars and researchers to date on the relationship between the two.

Attempting to fill this gap, this chapter provides an introduction to social entrepreneurship for city, state, and federal government officials. Based on case studies and interviews with experts, it breaks new ground in exploring the ways in which government leaders and ultimately their constituents are benefiting from social entrepreneurs' efforts. The author suggests that recent trends affecting business, nonprofits, and government have been instrumental in the emergence of social entrepreneurship as a new field. Collaboration between government leaders and social entrepreneurs is already occurring and generating numerous benefits for American society.

Although collaboration thus far between social entrepreneurs and government has occurred in isolated incidents, working together more strategically represents a yet-to-be-harnessed opportunity for government leaders working to resolve social problems. By adapting some of the same levers that have successfully encouraged U.S. entrepreneurialism, government leaders have a similar opportunity to support social entrepreneurship—and thereby generate transformative, financially sustainable solutions to social problems facing the nation. As Roger L. Martin and Sally Osberg state in a recent article for the *Stanford Social Innovation Review*, "Social entrepreneurship, we believe,

17 John. J. Havens et al., "Charitable Giving," 542. Data given in 2004 and adjusted by the researchers for inflation to 2002 dollars.

18 Fine and Foster, "How Nonprofits Get Really Big," 46–55.

is as vital to the progress of societies as is entrepreneurship to the progress of economies, and it merits more rigorous, serious attention than it has attracted so far."[19] Just as government support of private markets and entrepreneurship has fueled growth in the U.S. economy, so too can government's support of social entrepreneurship accelerate the solving of social problems.

To introduce social entrepreneurship to government and explore the relationship between social entrepreneurship and government, this chapter addresses three key questions:

What is social entrepreneurship? In the first section, the author outlines key trends that have pushed the public, private, and nonprofit sectors to blur their traditional economic and social roles, and show how social entrepreneurship has emerged at the nexus of these sectors. The author lays out his definition of social entrepreneurship in detail, using cases that highlight three successful social-entrepreneurial initiatives.

How does social entrepreneurship help government benefit Americans? The second section discusses how social entrepreneurship can help government benefit American society, as the field is uniquely situated to help improve the lives of public officials' constituents. Case examples show how social entrepreneurs leverage public and private resources, and test and develop new solutions to social problems.

How is government supporting social-entrepreneurial initiatives? Although government's efforts do not yet represent a coordinated, strategic approach to supporting social entrepreneurship, local, state, and federal government officials nonetheless have had significant impacts on every initiative considered in the development of this chapter. In this section, the author looks at methods used by government agencies and elected officials to (1) encourage social entrepreneurs to innovate, (2) create enabling environments for their efforts, (3) reward their performance, (4) help scale their successes, and (5) produce knowledge to help them solve social problems.

Three research methods are used to answer the three guiding questions: literature review, consultations with experts, and interviews with leading social entrepreneurs. The author reviewed a variety of academic and popular sources in the fields of social entrepreneurship, nonprofit and business management, public policy, and entrepreneurship, and consulted with leading experts, who were selected based on their reputation and scholarship in social

19 Martin and Osberg, "Social Entrepreneurship: The Case for Definition," 35.

entrepreneurship and related areas from academia, philanthropy, business, nonprofit management, and government.[20] Lastly, the author conducted interviews and developed case studies on eight successful examples of social entrepreneurship that are working within each of the three traditional sectors, targeting a variety of social problems, and representing a variety of geographic areas.[21] The eight examples are Benetech, City Year, ITN*America*, KaBOOM!, New Leaders for New Schools (New Leaders), Outside the Classroom, Resolve to Stop the Violence Program (RSVP), and Triangle Resident Options for Substance Abusers, Inc. (TROSA).

What is Social Entrepreneurship?

History abounds with examples of individuals who could be considered social entrepreneurs. Florence Nightingale, whose work in the mid- to late 1800s is regarded as the foundation of the modern field of nursing, and Horace Mann, who greatly reformed public education earlier in the same century, are often cited as historic examples of social innovators who changed America's social landscape.[22] Yet social entrepreneurship as a distinctive part of American social and economic life is a more recent development that can only be understood within the context of the changes that have taken place since the 1980s in the roles played by businesses, government, and nonprofits. This section will introduce social entrepreneurship within that context, providing an overview of the roles of the three sectors—public, private, and voluntary; a description of trends that have increasingly blurred the boundaries between these sectors, creating a space for social entrepreneurship to emerge; and a detailed discussion of the authors' definition of social entrepreneurship in the context of this blending of sectors, using case examples to illustrate.

Early threads of what would become the field of social entrepreneurship emerged in the United States just over two decades ago,[23] and the various

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20 Many of these conversations took place at the Skoll World Forum on Social Entrepreneurship, held at Oxford University in March 2007, and at New York University's Annual Conference of Social Entrepreneurs, held in April 2007.

21 To be included, each organization must have been an example of social entrepreneurship as defined in this chapter; regarded by others in the field as successful, sufficiently mature in its organizational development to demonstrate results, and based in the United States.

22 Bornstein, *How to Change the World.*

23 For a more detailed history, see Dees and Anderson, "Framing a Theory of Social Entrepreneurship."

names it has gone by throughout its early development help to illustrate its connection to all three sectors. In 1980, Edward Skloot founded a consulting firm to help nonprofit organizations interested in creating business ventures, which promptly became a pioneering institution of the field. His 1983 *Harvard Business Review* article coined the term "nonprofit entrepreneurship" to describe the use of business ventures as a method for diversifying nonprofit organizations' funding streams.[24] In 1981, private-sector consultant Bill Drayton founded Ashoka: Innovators for the Public to seek, support, and publicize individuals he originally called "public entrepreneurs," and later named "social entrepreneurs."[25] Management expert Peter Drucker's 1985 book *Innovation and Entrepreneurship* was among the first to describe entrepreneurship as a phenomenon that extended into multiple sectors—and was not limited to profit-seeking enterprises.[26]

The term social entrepreneurship began to appear routinely both in the scholarly and popular presses in the early to mid-1990s. Early descriptions of social entrepreneurs ranged from "anyone who starts a not-for-profit" to "not-for-profit organizations starting for-profit or earned-income ventures"[27] to "business owners who integrate social responsibility into their operations."[28] While debate on the exact definition continues to this day, most definitions describe social entrepreneurship broadly enough to include a variety of organizational structures and activities, and yet narrowly enough to recognize social entrepreneurship as a distinct field. Much of the difficulty of settling on the details, it is argued here, stems from the fact that social-entrepreneurial initiatives tend to exhibit characteristics of each of the private, public, and nonprofit sectors, without fitting neatly into any one of them. As examples throughout this chapter will show, social-entrepreneurial initiatives can take the form of nonprofits, for-profits, or governmental programs. Unlike traditional nonprofits, businesses, or government programs, however, such social-entrepreneurial initiatives will always exhibit characteristics of each of the sectors.

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24 Skloot, "Should Not-for-Profits Go into Business?"

25 Anderson and J Dees, "Rhetoric, Reality, and Research," 39–66.

26 Drucker, *Innovation and Entrepreneurship*.

27 Earned-income ventures are traditional for-profit businesses run within a nonprofit organization to help cover operational costs.

28 Dees, "The Meaning of 'Social Entrepreneurship,'" 1. All definitions listed in this sentence come from this article.

For this reason, understanding the ways in which the three sectors are well- and ill-suited to meeting America's social and economic needs provides the context, indeed describes the fertile opportunity, from which social entrepreneurship has emerged. As illustrated in Figure 6.1, each of these sectors has traditionally carried out specific roles and responsibilities, making vital contributions to the United States' economic and social health.

The Private Sector

The private sector is defined here as all the corporations, small businesses, and entrepreneurs utilizing markets to exchange goods and services to maximize profit, while driving increased innovation and productivity in the economy. Economists have long identified innovation as one of the private sector's defining characteristics. Writing in the mid-1900s, famed scholar Joseph Schumpeter commented, "entrepreneurial innovation is the essence of capitalism."[29] Further, contemporary economist Milton Friedman has argued that free markets, competition, and consumer choices are also essential components of capitalism.[30]

The private sector is by far the largest sector of the U.S. economy. The United States attains a gross domestic product of approximately $13 trillion a year.[31] Private-sector activity has created a national income more than twice that of Japan, the next largest national economy in the world.[32] U.S. citizens enjoy the third highest per capita purchasing power—or standard of living—in the world.[33] Among the more than 150 million adults in the U.S. work force,[34] less than 5 percent are unemployed,[35] with the vast majority of jobs provided by private sector businesses.

While the private sector contributes to the well-being of citizens by developing and distributing products and services, meeting consumers' needs,

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29 Schumpeter, *The Theory of Economic Development.*

30 Friedman, *Capitalism and Freedom*.

31 Central Intelligence Agency, *The World Factbook 2006*, https://www.cia.gov/library/publications/the-world-factbook/print/us.html.

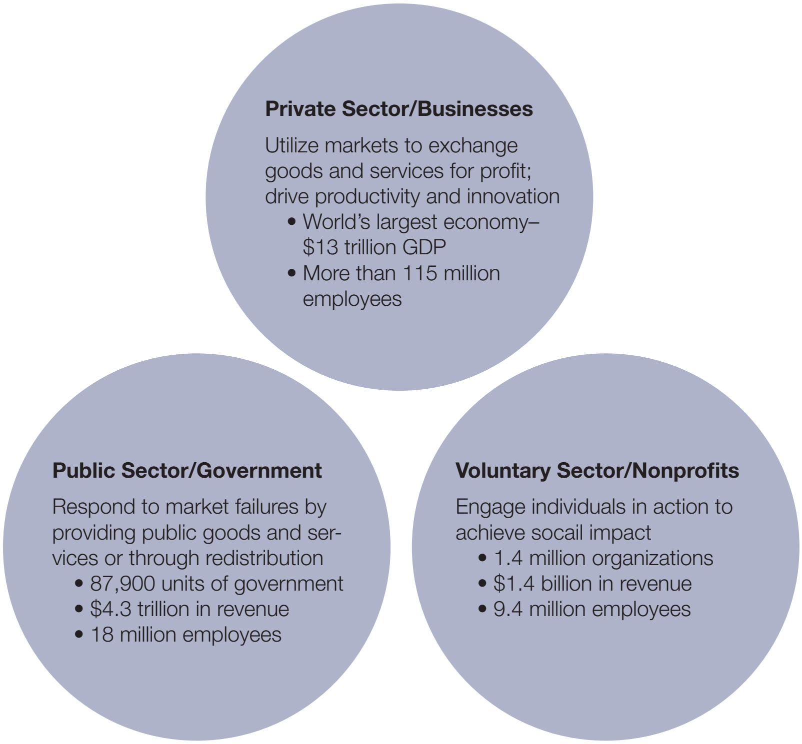
32 World Bank, *World Development Indicators 2006*, http://devdata.worldbank.org/wdi2006/contents/cover.htm.

33 Ibid.

34 Ibid.

35 U. S. Bureau of Labor Statistics, *The Employment Situation*, http://www.bls.gov/news.release/empsit.nr0.htm.

Figure 6.1 The Three Sectors' Traditional Economic and Social Responsibilities



creating jobs, driving innovation, and building wealth for the nation, it is often ill-suited to addressing social problems. Focusing on societal challenges has typically been left to the government and nonprofit sectors.

The Public Sector

Public-finance theory tends to assign two major roles to government: 1) providing public goods, such as libraries, public education, national defense, and policing; and 2) addressing inequalities produced by markets through redistribution—in the form of unemployment benefits, disaster assistance, or benefits to families living in poverty, to name a few of the most common methods.[36]

It is possible to elaborate on these two roles by thinking in terms of market failure, which occurs when the private sector alone cannot meet a societal need because the cost of providing the needed good or service is more than

36 Gruber, *Public Finance and Public Policy*.

its beneficiaries are able or willing to pay. Public goods such as public schools and libraries are classic examples of services that address market failures. Since such services do not provide the profits that would make them viable private-sector enterprises, the private sector leaves the need to educate the population unmet. Redistribution, which involves giving support to those not served by private markets, is another way in which government's role can be considered to be addressing market failures. By providing public goods and addressing inequalities in markets, then, government complements the private sector, filling in gaps left by market failures, while providing the structure and stability that allows the private sector and markets to work.

While much smaller than the private sector, the public sector nonetheless occupies a sizable part of the U.S. economy. According to the 2002 Census of Governments, 87,900 distinct government units operate across the nation: they include the federal government, 50 state governments, 3,034 county governments, and 35,937 municipal and township governments, as well as 48,878 "special purpose" local governments, such as school districts.[37] In 2006, federal government revenues were approximately $2.4 trillion per year,[38] while state and local governments generated approximately $1.9 trillion of revenue annually.[39] In the same time frame, government at all levels employs approximately 18 million full-time civilian workers.[40]

Despite its size and role, government faces tough choices in allocating its resources to meeting ever-evolving societal needs, and is often ill-suited to meet all those needs. It therefore often seeks the partnership and support of citizens, who tend to organize their efforts within the nonprofit/voluntary and private sector.

The Nonprofit/Voluntary Sector[41]

The nonprofit sector's traditional role is to engage individuals in action to achieve social goals. Typical examples include neighborhood associations,

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37 U.S. Bureau of the Census, *2002 Census of Governments*, 1.

38 U.S. Department of the Treasury, *2006 Financial Report*, 11.

39 U.S. Bureau of the Census, *State and Local Government Finances*, http://www.census.gov/govs/www/state05.html.

40 U.S. Bureau of the Census, *2002 Census of Governments*, 13.

41 Today, the terms "nonprofit sector" and "voluntary sector" are often used interchangeably, despite the continued existence of many voluntary groups that never formally organize to obtain nonprofit status. The term "nonprofit sector" is used throughout this chapter.

religious organizations, private hospitals and schools, and social service providers. The organizations and activities that constitute the nonprofit sector generally differ from the work of the public and private sectors in two ways. First, the nonprofit sector often acts when both the public and private sectors are unable to meet a particular social need.[42] Second, while nonprofit-sector organizations are private and self-governing, much like organizations in the private sector, nonprofit-sector organizations cannot distribute profits to their leaders, and must use their revenues and profits to sustain and grow their organizations.

While the nonprofit sector is by far the smallest of the sectors, it is also the fastest growing. Over the past 25 years, the total number of nonprofit organizations has approximately doubled.[43] Since 1994, the number of 501(c)(3) groups in the United States expanded from just over half a million to nearly 850,000, for a growth rate of almost 65 percent.[44] According to a study by the Nonprofit Employment Data Project at Johns Hopkins University, the nonprofit work force now makes up 10.5 percent of U.S. jobs. Between 2002 and 2004, nonprofit job growth outpaced that of the private sector in 46 out of 50 states, generating 5.3 percent more new jobs.[45] Currently, approximately 1.4 million tax-exempt organizations are registered with the Internal Revenue Service (IRS).[46] Nonprofit organizations generate nearly $1.4 billion of revenue annually, hold $3 trillion in assets, account for 5.2 percent of gross domestic product (GDP), provide 8.3 percent of wages and salaries paid in the United States,[47] and employ 9.4 million individuals.[48]

Tax deductions as incentives for charitable contributions have played a significant role in the growth and financing of the nonprofit sector. Yet, while the nonprofit sector has grown substantially in the past two decades and has been instrumental in meeting societal needs, its impact on a

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42 Weisbrod, "The Future of the Nonprofit Sector," 542.

43 Independent Sector, *Facts and Figures About Charitable Organizations 2007*, 2.

44 Urban Institute, "The Nonprofit Sector in Brief: Facts and Figures from the Nonprofit Almanac 2007," 3.

45 Johns Hopkins University, "Employment in U.S. Nonprofits Outpaces Overall Job Growth," http://www.jhu.edu/news_info/news/home06/dec06/employ.html.

46 Urban Institute, *The Nonprofit Sector in Brief*, 1.

47 Urban Institute, *The Nonprofit Sector in Brief*, 2-3: Note that these figures are inclusive only of the approximately half a million nonprofit organizations reporting to the IRS in 2004, a requirement for any with more than $25,000 in gross receipts.

48 Salamon and Sokolowski, *Employment in America's Charities,* 3.

national scale is still limited by its ability to sustain or scale initiatives. For future growth, it must rely on the much larger public and private sectors for financial resources and access to the channels that make scaling nonprofit solutions possible.

Blurring Sectors: Trends Creating Fertile Ground for Social Entrepreneurship to Emerge

Traditionally, each of the three sectors has maintained the distinct roles and approaches described above—with the private sector focused on profitable markets, the public sector solving market failures, and the nonprofit sector engaging citizens in meeting societal needs. Since the 1980s, however, several trends have reduced these distinctions, increasingly blurring the social and economic roles that businesses, government agencies, and nonprofits are playing. As Figure 6.2 illustrates, these trends have expanded the overlapping space between the sectors and created ample opportunity for social entrepreneurship to emerge and grow. As a result, social entrepreneurship exhibits characteristics of all three sectors.

In the private sector, businesses and their employees are increasingly engaging in activities that previously fell under the domain of nonprofits and government. For instance, private-sector companies have begun competing in fields such as education and social services, giving such companies opportunities to provide services that were once considered core government activities.[49] In fact, the number of private-sector contractors paid through federal funds increased by 700,000 from 1999 to 2002—from 4.45 million to 5.15 million people.[50] In another trend, following recent corporate scandals and financial crises, the private sector has faced new calls for business ethics.[51] These have led the private sector to begin to consider the role it plays in society beyond maximizing profits.

The public sector, too, has seen a shift in its practices. As *Reinventing Government* authors David Osborne and Ted Gaebler describe, government is increasingly steering rather than rowing and emphasizing cost-effective results over bureaucratic rules.[52] According to Stephen Goldsmith, Daniel

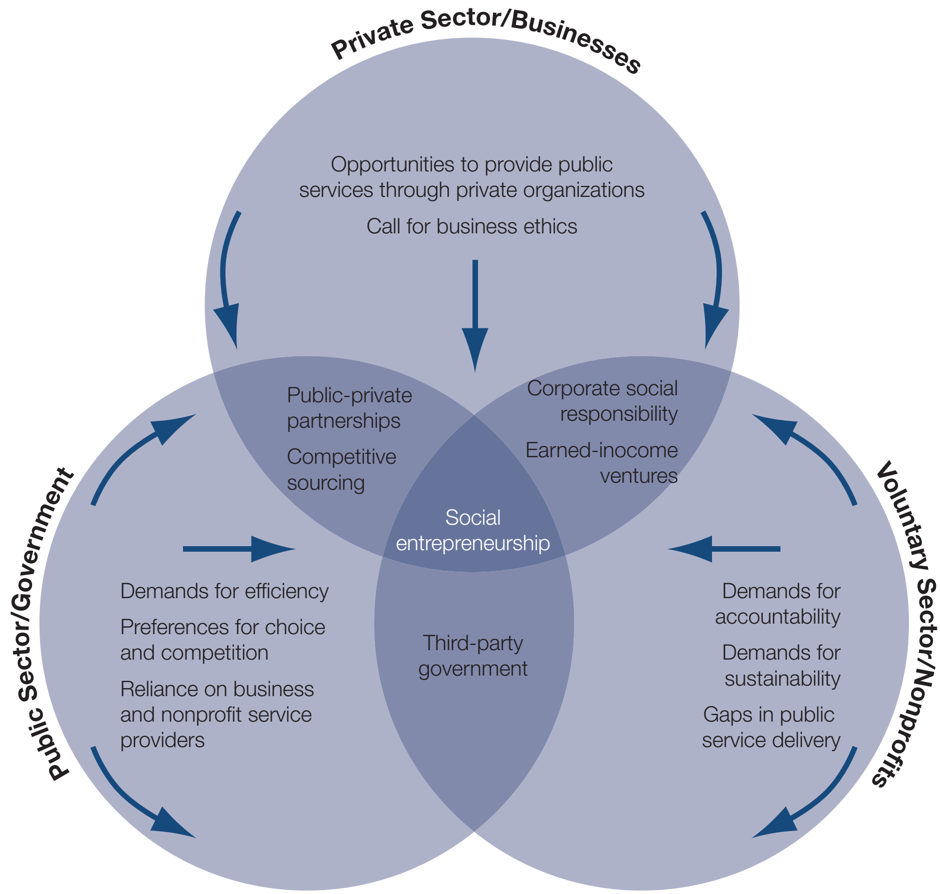
49 Salamon, *The Resilient Sector: The State of Nonprofits in America;* and Weerawardena and Mort, "Investigating social entrepreneurship," 21–45.

50 Light, *Fact Sheet on the New True Size of Government*, 4.

51 Lyndenberg, *Corporations and the Public Interest*.

52 Osborne and Gaebler, *Reinventing Government*, chapter 1.

Figure 6.2 Trends Pushing the Three Sectors to Blur Traditional Roles: Social Entrepreneurship Emerges in the Growing Intersection



Paul professor of government, and director, Innovations in American Government Awards Program at Harvard University's John F. Kennedy School of Government, "New Deal-style initiatives, in which government assumes the dominant service-delivery role, have become increasingly rare, especially for newly developed programs."[53] At the federal level, the past three administrations have "devolved"[54] and "reinvented"[55] government, pushing for

53 Goldsmith (professor, Harvard University), interview with the author, April 24, 2007.

54 Hall, *Inventing the Nonprofit Sector*.

55 National Partnership on Reinventing Government, archived Web site, http://govinfo.library.unt.edu/npr/index.htm.

"citizen-centered, results-oriented, market-based" approaches, respectively.[56] At state and local levels, limited budgets and persistent social needs have also increased demands for efficiency in the use of government funds.[57] Many constituents, accustomed to their choices in the marketplace, want to be thought of as consumers and express preferences for choice and competition on issues ranging from public utilities to public schools. In response, government agencies are ceasing to work as monopolies, and instead are relying on nonprofit and private service providers that are managed through contracts and the allocation of grant funds.[58]

For the nonprofit sector, pressures are growing to fill gaps in public service delivery, ensuring that citizens can get the services they need even when government is unwilling or unable to provide it. If they are to provide essential services, nonprofit leaders are striving for sustainability to ensure that they will continue to be able to meet the needs of the populations they serve. Following the national scandal at a major nonprofit in 1992, and as many foundations adopt outcomes-driven approaches to funding, nonprofits also face demands for accountability.

As each sector has entered the territory of the others, the blurring between them has given rise to a host of new phenomena, which Stephen Goldsmith characterizes as: "the reality of a world in which the public and private boundaries are becoming increasingly blurred and governments of all ideological bents are partnering with private companies and nonprofit organizations to do more and more of the government's work."[59] An increase in public-private partnerships has involved more and more businesses and nonprofits as collaborators in government projects. Further, President Bush's competitive sourcing initiative, which is currently being implemented, is slated to open half of the federal jobs that are "not inherently governmental" to market competition.[60] At the same time, the increased popularity of earned-income ventures has led many nonprofits to develop business-like ventures to generate revenues.[61] Lastly, corporate social responsibility move-

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56 Executive Office of the President, *The President's Management Agenda, Fiscal Year 2002*, 6.

57 Osborne and Gaebler, *Reinventing Government.*

58 Salamon, ed., *Beyond Privatization: The Tools of Government Action.*

59 Goldsmith and Eggers, *Governing by Network*, 23.

60 Light, *An Update on the Bush Administration's Competitive Sourcing Initiative*, 2.

61 Aspen Institute, *The Nonprofit Sector and the Market*, 6.

ments have entered the mainstream, motivating businesses to account for their community, environmental, and labor practices along with their profits. Whether to improve their images, gain marketing advantages, or altruistically benefit society, corporations have demonstrated a growing interest in volunteer and philanthropic opportunities.

Social Entrepreneurship Emerges at the Nexus

As trends have pushed the traditional roles of the three sectors to blur, their nexus has provided fertile ground for the growth of social entrepreneurship. As scholar Alex Nicholls from Oxford University's Skoll Centre for Social Entrepreneurship explains, social entrepreneurship is not defined by its organizational form but "is best understood as a multi-dimensional and dynamic construct moving across various intersection points between the public, private, and social sectors."[62]

By blending some of the social and economic responsibilities traditionally associated with each of the three sectors, social entrepreneurship may take the form of a nonprofit, business, or government initiative. No matter what organizational form it takes, social entrepreneurship also tends to exhibit characteristics of all three. Like business, social entrepreneurship utilizes markets to drive innovation and productivity. Like government, social entrepreneurship responds to market failures by providing public goods and services. Like nonprofits, social entrepreneurship engages individuals in action to achieve social goals. As Nicholls concludes, "The organizational mechanisms employed are largely irrelevant: social entrepreneurs work in the public, private, and social sectors alike, employing for-profit, not-for-profit, and hybrid organizational forms (or a mix of all three) to deliver social value and bring about change."[63] Returning to the definition, social entrepreneurship, then, is *the practice of responding to market failures with transformative, financially sustainable innovations aimed at solving social problems.*

This section discusses in detail the three essential components of this definition—1) response to market failures, 2) transformative innovations, and 3) financial sustainability—and offers three case studies that illustrate how social entrepreneurship exhibits these components.

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62 Nicholls, *Social Entrepreneurship*, 12.

63 Ibid.

Response to Market Failures

The social problems that social entrepreneurs address result from market failures—in which profitable markets are unavailable, insufficient, or underdeveloped and where the potential monetary gains for responding to a societal problem are less than the overall, society-wide positive impact of that response. Because of the lack of opportunity to generate profit, private-sector entrepreneurs—who succeed by finding market opportunities and maximizing profits—often leave these needs unaddressed. Traditionally, government responds in such cases by deploying public funds to address the unmet needs.

Social entrepreneurship presents another option for addressing market failures—which can be considered the sources of the opportunities that social entrepreneurs act on.[64] Like private-sector entrepreneurs, social entrepreneurs seek opportunities to create value—but the value they pursue is social rather than purely economic. As Gregory Dees, a founding scholar of the field of social entrepreneurship, explains, "Markets do not do a good job of valuing social improvements, public goods and harms, and benefits for people who cannot afford to pay. These elements are often essential to social entrepreneurship. That is what makes it social entrepreneurship."[65] Roger L. Martin and Sally Osberg echo this idea that social entrepreneurs can be considered entrepreneurs who pursue social value: "Unlike the entrepreneurial value proposition that assumes a market that can pay for the innovation, and may even provide substantial upside for investors, the social entrepreneur's value proposition targets an underserved, neglected, or highly disadvantaged population that lacks the financial means or political clout to achieve the transformative benefit on its own."[66]

Through interviews with leading social entrepreneurs and conversations with experts in the field, the author has identified three different types of approaches that social entrepreneurs take in targeting beneficiaries and responding to market failures (Figure 6.3).

64 Phills and Denend, *Social Entrepreneurs: Correcting Market Failures (A) and (B)*, 2.

65 Dees, "The Meaning of 'Social Entrepreneurship,'" 3.

66 Martin and Osberg, "Social Entrepreneurship: The Case for Definition," 35.

Figure 6.3. Market-Failure Continuum of Social-Entrepreneurial Approaches to Solving Social Problems

No Market — Limited Market — Low-profit Market

No Market

In a no-market approach to solving a social problem, the beneficiaries of the potential product or service will not be able to pay for it.[67] As a result, a social entrepreneur who selects such an approach cannot rely on any earned revenues from the beneficiary to sustain the initiative. Most commonly, no-market approaches take the form of government initiatives or nonprofit organizations.

Limited Market

In a limited-market approach, the beneficiaries or clients have some ability to pay. As a result, a social entrepreneur who selects such an approach can rely on some earned revenues from the beneficiary to sustain the initiative. Most commonly, limited-market approaches tend to be nonprofit organizations.

Low-profit Market

In a low-profit-market approach, the beneficiary has the potential to pay the full cost while solving the social problem and thus has the potential to generate a profit. However, the market may be underdeveloped, or investments in this market may yield returns that are less than typical for for-profit ventures. Examples of this type of approach exist in both the nonprofit and private sectors. In some cases, low-profit-market approaches eventually develop the market for a product or service enough that they become traditional for-profit enterprises.

Transformative Innovations

Ashoka Founder Bill Drayton has famously commented that “social entrepreneurs are not content just to give a fish or teach how to fish. They will not rest until they have revolutionized the fishing industry.”[68] Like other entrepreneurs, social entrepreneurs are creative thinkers, continuously striving for

67 Seelos and Mair, “Social Entrepreneurship,” 241–246.

68 Ashoka, “What is a Social Entrepreneur?” http://ashoka.org/social_entrepreneur.

innovation, which can involve new technologies, supply sources, distribution outlets, or methods of production.[69] Innovation may also mean starting new organizations, or offering new products or services.[70] Innovative ideas can be completely new inventions or creative adaptations of existing ones.[71]

Many scholars take this focus on innovation even further. Social entrepreneurs are "change agents,"[72] creating "large-scale change through pattern-breaking ideas,"[73] "addressing the root causes" of social problems,[74] possessing "the ambition to create systemic change by introducing a new idea and persuading others to adopt it,"[75] and changing "the social systems that create and maintain" problems.[76] These types of transformative changes can be national or global. They can also often be highly localized—but no less powerful—in their impact. Most often, social entrepreneurs who create transformative changes combine innovative practices, deep and targeted knowledge of their social issue area, applied and cutting-edge research, and political savvy to reach their goals. For all entrepreneurs, whether in the business or social realm, innovation is not a one-time event—but continues over time.

Of course, while addressing a social problem with a potentially transformative innovation is an essential component of the definition of social entrepreneurship offered here, succeeding in generating such transformation is not. The field, like any other, includes success stories and strong leaders, as well as those who fall short of their aspirations.[77] Nonetheless, the definition of social entrepreneurship requires that initiatives at least have the potential for transformative social innovation on a local, national, or global scale. This characteristic distinguishes social entrepreneurship from other nonprofit,

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69 Dees, "The Meaning of 'Social Entrepreneurship,'" http://www.fuqua.duke.edu/centers/case/documents/dees_sedef.pdf.

70 Mair and Marti, "Social Entrepreneurship Research," 36–44; Peredo and McLean, "Social Entrepreneurship: A Critical Review of the Concept," 56–65; and Dees, "The Meaning of 'Social Entrepreneurship,'" http://www.fuqua.duke.edu/centers/case/documents/dees_sedef.pdf.

71 Peredo and McLean, "Social Entrepreneurship: A Critical Review of the Concept," 56–65.

72 Ashoka, "What is a Social Entrepreneur?" http://ashoka.org/social_entrepreneur.

73 Light, "Searching for Social Entrepreneurs," 30.

74 Dees and Anderson, "Framing a Theory of Social Entrepreneurship," 46.

75 Kramer, *Measuring Innovation,* 5.

76 Alvord et al., "Social Entrepreneurship and Societal Transformation," 260–282.

77 Peredo and McLean, "Social Entrepreneurship: A Critical Review of the Concept," 59; and Light, "Reshaping Social Entrepreneurship," 46–51.

business, or government service providers that may be more narrowly focused on meeting the most pressing social needs as they emerge.

Financial Sustainability

While social entrepreneurship is not defined by any one standard model for achieving financial sustainability, working toward financial sustainability is essential if an approach to a social problem caused by market failure is to be successful enough to have transformative potential. Each organization must find a model responsive to the unique character of the social problem they are trying to solve, and grounded in the realities of the type of approach to market failure they have adopted. In addition, social entrepreneurs also tend to prefer business-like productivity and efficiency measures to determine their capture and use of resources. Many produce cost-benefit analyses, reports on "social" return on investment, report cards on organizational performance, or other integrated measures of financial and programmatic success that will ultimately help the organization optimize their use of resources and maximize their results.

While the details vary, such financial models generally include two components: nonfinancial resources and predictable revenue sources.

Nonfinancial resources

Nonfinancial resources are skilled or unskilled volunteers, and one-time or recurring in-kind donations that enable social entrepreneurs to increase the sustainability of their initiatives.[78] For instance, David Eisner, CEO of the Corporation for National and Community Service, points out that "Engaging the public in developing and implementing social solutions is a proven and inexpensive strategy. Look at the way nearly 600,000 volunteers were leveraged to complete intensely needed work in the year after Hurricane Katrina in a way we never could have paid for."[79]

Predictable revenue sources

Predictable revenue sources are long-term, repeat, and performance-based funding sources—foundation, individual, government, corporate, and fee-based—that will provide predictable funding, despite conditions of market

78 Bhawe et al., "The Entrepreneurship of the Good Samaritan," http://ssrn.com/abstract=902685.

79 David Eisner (CEO, Corporation for National and Community Service), interview with the author, April 30, 2007.

failure. Which type of predictable revenue sources a financial sustainability model contains will depend on the organization's approach to market failure, as well as the social problem being addressed. No-market approaches will look for long-term, repeat, and performance-based funding sources, and may also develop an earned-income venture to build into the model an alternative to receiving income from the direct beneficiary. Limited-market approaches will focus on the same funding sources as no-market approaches, in addition to collecting a portion of their costs from the beneficiaries of their product or service. Low-profit-market approaches will ask the beneficiary to pay, and look for "patient capital" from socially motivated investors who are willing to accept below-market returns, or wait for profits while the market is developed, in exchange for social impact.

Table 6.1 provides a summary of how the three components of social entrepreneurship appear in each of the three major approaches to market failure.

Case Studies of Social-Entrepreneurial Approaches to Solving Social Problems

Resolve to Stop the Violence Program (RSVP): A No-Market Approach to Reducing Recidivism

Market Failure

The United States has one of the highest incarceration rates in the world. According to a 2005 BBC report, U.S. recidivism rates are also high—at about 60 percent throughout the nation.[80] While reducing these rates would produce significant societal benefits in terms of reducing the overall prison population, cutting down on incarceration costs, and ultimately ending up with more productive citizens, there is little hope of a market-based solution to meeting this need.

Delivering rehabilitation programs to prisoners does not provide an opportunity to generate profit.

RSVP, a San Francisco-based government initiative housed in the city's sheriff's department, provides an example of a social-entrepreneurial initiative addressing a no-market opportunity. The prisoners who are the beneficiaries of its intensive rehabilitation program have no ability to pay for it.

80 Wikipedia, "Recidivism," http://en.wikipedia.org/wiki/Recidivism.

Table 6.1 Social-entrepreneurial Approaches to Solving Social Problems			
Approach to market failure	**No market** Target beneficiaries are unable or unwilling to pay.	**Limited market** Target beneficiaries are willing and able to pay partial costs.	**Low-profit market** Target beneficiaries are willing and able to pay if markets are developed.
Innovation	Innovation occurs in a variety of forms throughout the market-failure continuum, including starting new organizations; offering new products or services; and developing new or adaptive technologies, supply sources, financing methods, distribution outlets, or methods of production.		
Strategies for financial sustainability	**Full subsidy** Makes use of nonfinancial resources: skilled or unskilled volunteers and one-time or recurring in-kind donations. Focuses on predictable funding sources. May build an alternative to receiving income from a target beneficiary into the model for addressing the problem.	**Partial subsidy** Makes use of nonfinancial resources: skilled or unskilled volunteers and one-time or recurring in-kind donations. Asks beneficiaries to pay partial costs to generate earned income while addressing the social problem. Focuses on predictable funding sources. May build an additional income source into the model to supplement income from a target beneficiary.	**Patient or below-market investment** Often makes use of nonfinancial resources: skilled or unskilled volunteers and one-time or recurring in-kind donations. Creates a market with support of patient capital from socially motivated investors who are willing to accept below-market returns and/or wait for profits in exchange for social impact. Once mature, relies on beneficiary payments and/or revenues generated while addressing the social problem.
Likely organizational form	Government agencies or nonprofit organizations.	Nonprofit organizations.	For-profit companies or nonprofit organizations.

Transformative Innovation

When Sunny Schwartz decided to start the first correctional program in the country to adopt a restorative-justice approach to reducing recidivism, she was already working with violent offenders at a San Francisco County prison and had grown dissatisfied with traditional approaches to prisoner rehabilitation: "It was clear that we weren't reaching most people in any kind of sustained, pro-social way." With the support of San Francisco Sheriff Michael Hennessey, Schwartz put together a diverse planning committee of former offenders, crime victims, and community leaders to participate in the development of the RSVP model: "We had victim's rights advocates. We had formerly abusive men and gang members. We had orthodox rabbis, Baptist ministers, atheists. We had deputy sheriffs from line staff to upper echelon. And then we had the usual stakeholders—probation and people on the bench."[81]

The resulting program differs from the usual approaches, which tend to focus either on punishment for the crime or rehabilitation of the offender, by encouraging and teaching offenders to take responsibility for their crimes. While some elements of RSVP programming resemble what might be found in typical rehabilitation programs—English and GED classes, parenting programs, and substance abuse treatment—the program also includes a class that teaches offenders to experience empathy for those who have been harmed by violence. Victims of crimes work with former offenders, community members, business organizations, and other stakeholders to develop the curriculum used for these classes, and to participate as trainers. When offenders are released from prison, many participate in an "internship" program and receive employment training while performing restorative acts in the community. Those who are successful eventually return to the prison as facilitators of RSVP sessions. Additionally, some of the victims of the RSVP participants also become advocates and work with RSVP.

The results that RSVP's innovative programming has generated thus far indicate that the organization is on its way to developing a rehabilitation method for violent offenders that has the potential to transform current practices in U.S. prisons and change beliefs about what is possible when working with prisoners. An independent, quantitative evaluation of RSVP found that the average annual incidence rate for fights and other forms of in-prison violence for their program participants is essentially zero, compared with 28 in a traditional "lock-up" prison setting—even though the participants sleep in open dorms. Further, offenders who participated in the program for at least eight weeks had a 46 percent lower rate of re-arrest for violent crime than those who served their time in a traditional jail. This difference increased to 83 percent for those who completed at least 16 weeks of the program.[82]

The organization is currently looking for ways to take its methods to other parts of the country. To date, jurisdictions in Austin, Texas, and Westchester County, New York—in addition to several local high schools—have approached RSVP for advice on replicating the program; organizations

81 Sunny Schwartz, (program administrator, RSVP), interview with the author, April 17, 2007.

82 Gilligan and Lee, "The Resolve to Stop the Violence Project: Reducing Violence through a Jail-Based Initiative."

from New Zealand, Poland, and Mexico have begun to replicate the RSVP model as well.

Financial Sustainability

For no-market approaches like that of RSVP, achieving financial sustainability requires full subsidies in order to start and maintain the initiative. One option in no-market conditions is to work within the government, where public funding is available. RSVP, whose staff is made up entirely of public employees, provides an example of this. Based on its results, the program was able to secure predictable funding in the form of a line item in the City of San Francisco's budget.

Triangle Resident Options for Substance Abusers Inc. (TROSA): A Limited-Market Approach to Long-term Substance-Abuse Treatment

Market Failure

A major gap exists in the United States between the needs of low-income people suffering from substance abuse and the treatment programs available to them. While addiction is a problem that people can suffer from for years or even decades, few public programs offer more than 30 days of treatment. Since this population has little ability to pay even for short-term treatment, markets have left the need for long-term care for substance abusers unaddressed.

The North Carolina–based nonprofit TROSA takes a limited-market approach to addressing this problem. The organization has developed a model that makes it possible for its beneficiaries to help cover a portion of the costs of the services they receive.

Transformative Innovation

TROSA provides a two-year residential treatment program, which includes counseling, education, and what Founder Keith Artin calls vocational therapy: "everything from someone learning a very specific trade—like getting a truck license—to basic on-the-job work ethics."[83] While the programming alone is a highly innovative approach to substance abuse treatment, equally innovative is TROSA's model for delivering this program to its residents at

83 Artin, (founder, TROSA), interview with the author, May 9, 2007.

no financial cost. Residents "pay" for the services they receive by working in either the operations of the program itself—helping with food preparation, transportation, and administration—or in one of the organization's many businesses, including TROSA Moving, TROSA Lawn Care, and TROSA Furniture and Frame Shop.

Financial Sustainability

As with many limited-market opportunities, the challenge is making this program financially sustainable, as the vast majority of those in need of long-term treatment for substance abuse have little ability to pay for such services. TROSA's model addressed this challenge by using revenues earned from their business ventures to cover more than two-thirds of TROSA's operating needs. The organization fills the remaining gap with support from other predictable funding sources.

Outside the Classroom: Identifying a Low-Profit Market for Drug and Alcohol Awareness on College Campuses

Market Failure

Each year, 1,700 college students in the United States die from alcohol-related causes. Colleges and universities have long focused on hosting guest speakers and alcohol-free social events to address the problem, but the market has failed to produce a more effective solution.

The for-profit organization Outside the Classroom set out to fill this need through a low-profit-market approach. The organization knew that a profitable market existed for its Web-based curriculum, yet several factors limited that market. An Internet-based curriculum designed to be administered to the entire student population was not a product that colleges and universities were accustomed to paying for. Additionally, all of the potential purchasers, public and private colleges and universities, operate as nonprofit organizations. While the potential for profitable sales did exist, it did not promise quick or substantial returns for early investors.

Transformative Innovation

Recognizing that drinking and drugs are commonly represented as a standard part of the U.S. college experience in American music, movies, and advertisements, Outside the Classroom Founder Brandon Busteed set out to change that perception. The organization's innovation is a curriculum designed to educate entire campus populations, in order to influence not only individuals' choices but campus culture as a whole.

In six years since its first sale of its Web-based curriculum, Outside the Classroom has begun to change the way some colleges and universities think about alcohol and drug abuse prevention. During the 2006–2007 academic year, approximately 25 percent of first-year college students across the nation completed the Outside the Classroom's web training. Early results have been promising: an independent study examining the efficacy of Outside the Classroom's programming found that students who had used its online prevention program, AlcoholEdu, experienced 50 percent fewer negative consequences related to alcohol—blackouts, hangovers, missed classes, physical fighting, unprotected sex, damaging property, and driving drunk—than those who did not.

Financial Sustainability

Like most social-entrepreneurial initiatives with a low-profit-market approach, Outside the Classroom faced its biggest challenge in its start-up phase. During that period, the organization was initially turned down by dozens of grant makers and relied on patient angel investors to cover the significant up-front costs for creating a curriculum and developing a market for it. As angel investor Ed Roberts, professor of management of technology at MIT's Sloan School of Management, recalls, "When I invested in Outside the Classroom, I was doing it primarily as a socially good act, with little faith that I would ever see a return on my investment. The idea was highly speculative as to whether or not it would work and have any real impact. But I wanted to join my friend Howard Anderson in assisting this cause in which he strongly believed. I now see that often times allowing underdeveloped but potentially socially meaningful markets to grow can produce good returns, both in regard to the original social purpose as well as from an investor's financial perspective."[84] The financial backing of investors who understood that their support had the potential of creating social benefit in addition to generating profits ultimately provided Outside the Classroom with time to do both. Today, Outside the Classroom has captured 25 percent of the

84 Ed Roberts, (professor, Massachusetts Institute of Technology), interview with the author, June 12, 2007.

college and university market, and some six years after initially lending their support, investors are now seeing their first returns.

Summary: What is social entrepreneurship?

Each of these cases shows how social entrepreneurship takes up an opportunity to provide a solution to a social problem that has great potential societal benefit, but little hope of generating the profits required by traditional for-profit companies. Social entrepreneurs—adopting no-market, limited-market, and low-profit-market approaches—address these problems while striving for what can be considered a different kind of profit: the generation of new and transformative solutions to the nation's most pressing social problems. The next section will show how social-entrepreneurial initiatives are helping government benefit Americans by leveraging public and private resources and testing and developing solutions.

How Does Social Entrepreneurship Help Government to Benefit Americans?

The previous section described social entrepreneurship and its emergence because of trends increasingly causing the traditional roles of the private, public, and nonprofit sectors to blur. This section provides examples of social entrepreneurs who, as new contributors in the realm of social problem solving, have come to serve as resources for government as it addresses social problems to improve the lives of Americans. As Citizens Schools Co-founder and CEO Eric Schwarz explains, "The best social entrepreneurs have great results. Government is looking at ways to get results at low costs. Social entrepreneurs can help them achieve this. They can test new ideas and innovations, and partner with government to bring successful ones to scale."[85]

Government leaders continually face pressures to allocate limited tax revenues to address pressing societal needs, and many have achieved a great degree of success. While social entrepreneurs will never take the place of government, conversations with social entrepreneurs and experts in the field suggest that social entrepreneurship is uniquely positioned to help government officials better address societal needs. Specifically, the social entrepreneurs interviewed help government improve the lives of their constituents in

85 Eric Schwarz, (CEO, Citizen Schools), interview with the author, April 26, 2007.

two primary ways: (1) leveraging public and private resources and (2) testing and developing solutions.

Five case studies illustrate how a variety of social-entrepreneurial initiatives have brought about these benefits.

Leveraging Public and Private Resources

Because of their focus on financial sustainability, social entrepreneurs identify and utilize new and existing resources, both financial and nonfinancial, to help them address social problems. Often this means that social entrepreneurs are able to implement solutions to social problems on a wider scale that have previously been too costly. At times, social entrepreneurs also end up shifting costs from public budgets to private resources, thus freeing up government tax revenue to address other needs.

KaBOOM!

Market Failure

Swings, slides, and seesaws are the setting for many a childhood memory. Creation of those playgrounds and outdoor play spaces for children has traditionally fallen under the domain of local parks and recreation departments of municipal governments. For many communities, however, building quality playgrounds competes with a variety of other pressing needs for limited public funds—often leaving children in poorer communities without access to great places to play. Unfortunately, the same places that lack public resources for playgrounds also typically lack private ones, as the parents who live there cannot pay for their own playground equipment.

Transformative, Financially Sustainable Innovation

KaBOOM!'s innovation was to leverage private resources by identifying an alternative revenue stream that would provide the organization with the funds to build quality playgrounds in underserved communities—thus adopting a no-market approach that channels new resources for playgrounds into these communities where the beneficiaries have no ability to pay. By working with major companies, including Home Depot, Sprint, and PepsiCo, KaBOOM! has been able to offer two products—corporate team-building and social marketing—that capture resources for playground building via donations, service fees, and employee volunteer time. According to Founder

Darrell Hammond, "It's beyond sponsorship. It's beyond partnership. We've really embedded ourselves into corporations and become a part of their long-term strategy—not just their community affairs and do-good strategy, but their business strategy as well, which means that, from a fee side, they're willing to pay for it."[86] Corporate volunteers gain team-building experience as they work with neighborhood residents and one another to fund, design, and build new playgrounds. KaBOOM! also works with companies to develop social-marketing campaigns centered on KaBOOM! projects. The result is a financial model that is almost 100 percent supported by fees.

As KaBOOM! has expanded in size and reach, the organization has been able to achieve even greater efficiency in its financial model, as a result of the cost efficiencies and benefits gained from operating at a much larger scale than municipal parks and recreation departments ever could. By linking a social problem without a market to a stable source of resources, KaBOOM! has built 1,196 new playgrounds in 11 years.

Societal Benefits

KaBOOM! has helped government to benefit Americans by developing and leveraging a new source of private resources that supplements public budgets, and at times even shifts costs from public budgets to private resources. This approach has helped to build playgrounds in communities that otherwise never would have been able to build them, or that can now spend the funding that would have been spent on the playground on other priorities.

ITNAmerica

Market Failure

Too often, older Americans must choose between their safety and their mobility—between continuing to drive as their abilities decline or remaining homebound and dependent on others after giving up their cars. Prior attempts to address this problem have failed to fully meet the needs of their target senior consumers. Senior transportation programs, often government funded, have typically relied on attempts to convince older people to ride buses or subways; on organizing volunteers to pick up vanloads of seniors for group trips; or offering rides to a handful of specific destinations, such as medical appointments. Finding these options insufficient, many

86 Darrell Hammond, (founder, KaBOOM!), interview with the author, April 17, 2007.

seniors continue to drive when they are no longer fit to operate a vehicle, or become increasingly housebound as they restrict their own driving and become dependent on favors from family and friends. As ITN*America* Founder Katherine Freund explains, "Depending on the private automobile for transportation is inadequate for years before people actually stop driving. And then people who do stop driving outlive that decision by about ten years. It's a very big problem because of the aging of the population. There are more older people. There are more older people living longer. There are more older people outliving the ability to drive longer. You can see if you multiply those things together you come up with a pretty big social problem."[87]

Transformative, Financially Sustainable Innovation

ITN*America* created a new option for seniors: providing rides in private cars available 365 days a year, 24 hours a day, with "door-through-door" service using a combination of paid and volunteer drivers. Taking a limited-market approach, ITN*America* charges a nominal one-time membership fee of $35 and about 50 percent of the cost of a taxi for each ride. Payments must be made for every ride, but no money changes hands in the vehicle. Seniors fund their personal transportation accounts in advance and receive a monthly statement in the mail.

As the organization has embarked on an ambitious five-year growth strategy, ITN*America* has been quite efficient in leveraging private resources. According to Freund, "We have a very flexible approach to resources. We say money is one kind of resource, but there are other kinds of assets that have economic value. And if we can find a way to capture different kinds of economic value, then we can use those resources also to pay for rides."[88] Volunteer drivers, for example, make up about 40 to 60 percent of the driving team. This helps the organization keep costs manageable, and also offers a way for seniors to subsidize the cost of their own rides. Many of the volunteers who are over the age of 60 contribute their own volunteer driving time through ITN*America*'s Transportation Social Security program, building up credits in their personal transportation accounts for their own future use of the services while they are still safe and healthy

87 Katherine Freund, (founder, ITN*America*), interview with the author, March 3, 2007.

88 Ibid.

to transport others. Family members may also supply volunteer time and make in-kind contributions of their driving credits to their relatives who are using the service. Seniors may trade their personal vehicles when they are no longer able to use them and apply the liquidated equity to fund their personal transportation accounts. The donated vehicles are often used to deliver rides.

In addition, ITN*America*'s software, ITN*Rides*, plans and tracks membership accounts, rides, and distances, maximizing the efficiency of routes. Freund characterizes this system as one of the organization's most important innovations: "One way to describe it is that we married a very grassroots model to a very high-tech support system. So we used technology to create efficiency, and we took the unusual step of building it ourselves, instead of purchasing off-the-shelf technology, so that it would be affordable to small organizations and communities."[89]

Societal Benefits

ITN*America* has developed a highly efficient model that ultimately funds itself—by capturing nominal fees from customers and leveraging private resources through volunteer time and community philanthropic support. When the organization starts up an affiliate program in a new city, it limits the amount of public funding it accepts to 50 percent or less of the capital necessary. Moreover, no public funds may be used for day-to-day operations, because ongoing use of public funds crowds out the development of the private community support so essential for long-term sustainability. Freund explains, "Most of the resources for transportation are private. If you don't have a model that is built to access them, then you'll fall into the pattern of being one of many providers in a turf war over the public dollars."[90] She notes that while many social problems require ongoing public support, senior transport—which targets a population willing and able to pay modest fees—is not one of them. Once ITN*America* affiliates reach their full capacity, the public funding that helped to get them started can be directed to other needs. As a result, ITN*America* leverages minimal initial support from government to meet the transportation needs of older Americans across the country.

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89 Ibid.

90 Ibid.

Testing and Developing Solutions

Despite the best efforts of government, nonprofits, and individual citizens, solutions for social problems can be hard to find. As Gregory Dees notes, "With all of our scientific knowledge and rational planning, we still do not know in advance what will work effectively. Thus, progress in the social sphere depends on a process of innovation and experimentation…an active, messy, highly decentralized learning process."[91] Given the challenges—and frequent failures—of attempts to innovate, social entrepreneurs supply a second valuable benefit to government. According to Jeffrey Robinson, assistant professor of management and entrepreneurship at New York University's Stern School of Business, "Experimentation is the value of social entrepreneurship to government. How do you break a logjam? Social entrepreneurs are often successful in figuring it out."[92]

The remaining three cases in this section provide examples of how social entrepreneurs have helped government benefit Americans by developing solutions, testing new theories, or designing new approaches to addressing social problems.

City Year

Market Failure

The idea of voluntary national service—what City Year Co-Founder Michael Brown defines as "calling on America's youth to give a year or more in service to the community and country to tackle pressing domestic needs and problems"[93]—has a long history in the United States. More than 100 years ago, philosopher William James called national service the "moral equivalent to war," suggesting that national service could be seen as an alternative to military service, serving one's country through volunteerism. More recently, during the civil rights era, many advocated social integration through service. Political leaders and commentators ranging from Senator Ted Kennedy of Massachusetts on the left to William Buckley on the right were champions of

91 Dees, "Taking Social Entrepreneurship Seriously," 26.

92 Jeffrey Robinson, (professor, New York University), interview with the author, April 12, 2007.

93 Brown, *National Service or Bust,* 4.

the idea.[94] Despite considerable interest, however, national service never took off. Brown characterizes the issue as one of "passion and dissonance," and theorized that national service—like the television and home computer—was an "experiential product" that the country needed a chance to see before they would know how much they wanted it. But national service was not the kind of service for which its beneficiaries could pay. Those serving would be volunteers, unlikely to be willing to pay for a volunteer opportunity even if they had the means. Those they would serve would also have limited if any means to pay.

Transformative, Financially Sustainable Social Innovation

Setting out to create an "experiential product" that would show Americans what national service could accomplish, City Year's founders started by considering the service programs that were already in existence. The small, state-based service corps tended to be focused on physical labor and often open only to low-income or high-risk youth needing professional skills. Brown and Co-Founder Alan Khazei were determined to make City Year different. They extended the time of service to a full year. They recruited "corps members" from a wide range of backgrounds, bringing together young people of different classes, races, and educational experiences. While a small portion of the work is physical, City Year's volunteers primarily focused on education and youth development, serving as mentors for children in partnership with public schools and organizing and running after-school programs and curricula on social issues including domestic violence prevention, AIDS awareness, and diversity.

In its early development, all City Year activities ran on private funding: corporations sponsored "teams" of volunteers. The decision to begin without government funds was largely a strategic one. In Brown's words, "If national service were to ignite civic energy, then citizens, private organizations, and companies needed to be engaged in its development and implementation… Rather than the creation of a new, single, 'silo-ed' government program, national service, we and others believed, should release civic energy and therefore be rooted in citizen, nonprofit, and private sector initiative."[95]

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94 In 1989, Kennedy sponsored S1439, "A Bill to Enhance National and Community Service, and for Other Purposes." For Buckley's position on national service, see Buckley, *Gratitude: Reflections on What We Owe to Our Country*.

95 Brown, *National Service or Bust*, 14.

Societal Benefits

As City Year's privately funded model for national service gained strength, it captured the attention of the architects of two government initiatives dedicated to promoting national service: the Corporation for National and Community Service and AmeriCorps. According to Brown, "President Clinton would later say that his visit to City Year [during his 1992 presidential campaign] helped to inspire his creation of AmeriCorps by providing him with a concrete example to which he could point to show others that his vision for national service could work." City Year became one of 800 nonprofits to receive federal funding for AmeriCorps's service programs. City Year's model helped to supply government with the information it needed to create a program that now provides diverse groups of young Americans access to a wide variety of national service opportunities. These young Americans, in turn, provide services to communities in need across the country.

New Leaders for New Schools (New Leaders)

Market Failure

In school districts located in low-income communities across the United States, many students are performing below national standards—leaving them with fewer skills and lowered prospects for long-term economic success. New Leaders founder Jon Schnur observed that in the school settings that served as exceptions to this rule, strong leadership by a committed principal was a common factor. "We've never seen a great classroom without an effective teacher, and we've never seen a school driving results for all kids without a great principal. Even where you've got good teachers, they don't stay and they don't work together in the right way and ultimately collaborate in the right way without a great principal."[96] Yet there was little focus on the recruitment, selection, or training for these essential school leaders, who "used to be largely expected by the system to be the manager of the bureaucracy and the status quo, and an operational manager keeping things running smoothly."

Transformative, Financially Sustainable Social Innovation

New Leaders was founded to test the hypothesis that putting resources towards selecting, training, and supporting principals who are committed to

96 Jon Schnur, (founder, New Leaders), interview with the author, March 30, 2007.

meeting high standards—even for children in the toughest neighborhoods with access to the fewest resources—will have a positive impact on students and ultimately the entire school's performance. Through a highly competitive process, New Leaders identifies educators whose values and skills suggest they can "lead and build schools' cultures to drive high expectation for all kids," and trains them to lead high-performing schools. Applications to the program are numerous: only approximately 6 percent of applicants are selected each year. Those chosen spend an intensive year as "residents" in an urban school, and then receive placement assistance and ongoing support as they take the reins as principals in schools of their own. Through partnerships in several large city school districts, New Leaders' no-market approach is supported in part by public funds, in the form of the salaries their residents and principals receive from the school district where they work. These public funds are supplemented by the support of several long-term philanthropic donors, who cover the costs of screening, selecting, training, mentoring, and providing ongoing support to their principals.

Six years of experience now show that their initial hypothesis—that a committed, supported, high-quality principal could transform student performance—has proven true. New Leaders presently operates in nine cities across the nation: New York City, the District of Columbia, Chicago, Memphis, Oakland, Baltimore, New Orleans, Prince George's County (MD), and Aspire Public Schools (CA). New Leaders–trained principals lead as many as 25 percent of the students in those districts. Approximately 95 percent of people who train with New Leaders take on school leadership roles—80 percent as principals—compared with fewer than half of principal trainees becoming principals in other, more traditional programs. Their schools show an improvement in student test scores. Across the 2004-2005 and 2005-2006 academic years, 100 percent of schools led by New Leaders principals for at least two consecutive years achieved notable increases in student achievement, with 83 percent achieving double-digit gains. Average student achievement gains ranged from 14 to 22 percentage points by city over the two-year period.[97] The organization is currently striving "to recruit and place enough people to provide 25 percent of the new urban principals needed in the U.S. by 2012."[98]

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97 This represents New Leaders for New Schools' data for performance in math and English language arts in schools led by a New Leaders principal for at least two consecutive years as of 2005–2006, and for which school-level achievement data were publicly available for both school years.

98 Schnur interview, March 30, 2007.

Societal Benefits

New Leaders provides an example of how social-entrepreneurial experimentation, when successful, can produce new practices that, once they've been tested and honed, government can take up to benefit Americans. New Leaders was able to take on the initial costs and risk of testing out its theory that principals trained to be great leaders can build high-performing schools. Now, city governments across the country are looking to New Leaders as a model. Some have brought New Leaders to their cities, while others have started their own principal-leadership programs, based on the New Leaders approach, in order to provide their students with the highest quality education possible.

Benetech

Market Failure

Twenty years ago, if a blind person wanted to read printed text not available in Braille, depending on the help of someone else was just about the only choice. The best available technology for a blind person to read printed text, a machine the size of a clothes dryer with a five-figure price tag, was an unrealistic and unaffordable option for accomplishing daily tasks like browsing a newspaper or looking over a piece of mail. The technology for creating an affordable, portable machine existed. However, the potential customer base, blind individuals and their employers, was too small to promise a traditional return on investment. As a result, technology investors were unwilling to take the risk to develop such a product.

Transformative, Financially Sustainable Social Innovation

Benetech was founded as a low-profit-market approach to ensuring the development of technology that promises to have a high social value despite low potential for generating a typical return on investment. As Founder Jim Fructerman explains, "The last 18 years have been great years for the computer industry. Computers have gotten faster, better, cheaper, smaller, lighter, brighter. What we've done is essentially ridden the back of that industry to say: 'How can we take advantage of these high-performance, low-cost platforms and turn them into effective tools for people with disabilities?'"[99] The company's first product, the Arkenstone Reading Machine, makes use of the optical character recognition (OCR) technology found in scanners, and can be used with a personal computer to scan and read text aloud.

At a cost of less than $2,000, the Arkenstone Reading Machine quickly found a larger customer base than originally predicted. In addition to blind individuals and their employers, people with learning disabilities and government agencies that serve the disabled, including the U.S. Department of Veterans Affairs, began purchasing the product. This unexpected, expanded customer base helped to generate millions of dollars in revenue annually, and ultimately led to the sale of the reading machine and the Arkenstone brand to a for-profit distributor of disabilities products. The machine is now in its fourth release and remains an industry-leading product.

The Arkenstone Reading Machine provides an example of how a low-profit-market approach can eventually develop a market that could be served by a traditional for-profit approach. In Benetech's case, selling the reading machine to a for-profit distributor once there was a sufficient market has enabled the organization to fund the development of other socially valuable technology solutions, without being constrained to those projects with high potential for significant profitability.

Societal Benefits

Benetech was able to test and ultimately develop a self-sustaining solution to a problem caused by a market failure that government was unable to address. Its inexpensive reading machine, tested in the early stages by accepting below-average returns, ultimately ended up creating a new and profitable market, in addition to serving the thousands of Americans who previously were unable to read printed text on their own. Among Benetech's customers was the U.S. Department of Veterans Affairs, which was able to better meet the needs of disabled Americans.

Summary: How social entrepreneurship benefits Americans

By identifying new methods of leveraging public and private resources to address social problems, in addition to testing and developing promising solutions, social entrepreneurship complements government's role in addressing market failures to benefit Americans. As Share Our Strength Founder

99 Jim Fruchterman, (founder, Benetech), interview with the author, March 15, 2007.

Billy Shore points out: "It is not what social entrepreneurs do instead of government but rather that they create a pipeline for government. Social entrepreneurs do things that government cannot do. They take more risks. They are closer to the people that they are designed to serve."[100] The section that follows will show how government has already been supportive of individual social entrepreneurship initiatives.

How is Government Currently Supporting Social-entrepreneurial Initiatives?

The previous two sections described what social entrepreneurship is and how social entrepreneurs help government benefit Americans—as they leverage public and private resources, and test and develop solutions. This section explores a variety of ways in which all levels of government have supported social-entrepreneurial initiatives. Interviews for this report revealed that, while government currently lacks a comprehensive and strategic approach for collaborating with social entrepreneurs, isolated incidents do exist of local, state, and federal employees working with social entrepreneurs on a number of initiatives addressing a variety of social problems. The cases presented in this section are organized according to the five primary methods, uncovered during the interviews, that government has employed to support social entrepreneurship:

- Encouraging social innovation;
- Creating an enabling environment for social entrepreneurial initiatives;
- Rewarding initiatives for their performance;
- Scaling initiatives' success; and
- Producing knowledge that enhances social entrepreneurs' efforts.

Encouraging Social Innovation

For any entrepreneur, the start-up period of an organization is critical. In the private sector, one-third of new employer establishments do not survive the first two years, and more than half fail in the first four years.[101] For social entrepreneurs, launching a new initiative can be just as challenging. To help

100 Billy Shore, (founder, Share Our Strength), interview with the author, May 30, 2007.

101 U.S Small Business Administration, Office of Advocacy, "Frequently Asked Questions," http://www.sba.gov/advo/stats/sbfaq.pdf.

social entrepreneurs endure the trials of the start-up phase, several foundations, most prominently Echoing Green and Ashoka, provide support specifically for early organizational development. In addition, various academic programs sponsor competitions and awards to encourage social innovation and the founding of new initiatives. According to Surdna Foundation Director Edward Skloot, government, too, has an important role to play in what he calls "acting as a seedbed for innovation."[102] Skoll Foundation's Lance Henderson echoes this sentiment: "There is no doubt that if government could take a more proactive role in thinking what its role would be in encouraging social innovation, it could be a significant contribution."[103] In the cases discussed below, government encouraged social innovation by providing seed funds to support social-entrepreneurial initiatives in their start-up phases.

ITN*America* takes pride in the fact that its daily operations are intentionally self-funding—and therefore independent of government dollars except as part of the start-up phase of a new affiliate. Yet ITN*America* would not be where it is today without the federal seed funds it received to help get its model up and running. The Transit IDEA program, administered by the Transportation Research Board of the National Academies of Science and funded by the Federal Transit Administration, provided two milestone grants that Founder Katherine Freund characterizes as the organization's "first big piece of venture funds."[104] The first grant, a feasibility study, enabled Freund to explore senior citizens' consumer behaviors related to fee-based automobile transportation services. The second study explored innovative payment plans and information system technology. When a third grant from the Federal Transit Administration spanned an administration change and was cut short, Freund mobilized a network of ITN supporters to contact their congressional delegates. Soon, the Federal Transit Administration agreed to directly fund ITN's model development.

In another example, RSVP received what was, in essence, government seed funding delivered through noncapital resources. When Program Administrator Sunny Schwartz set out to create a new approach to rehabilitating violent offenders, her boss, Sheriff Michael Hennessey, authorized her to devote a considerable portion of her time, and that of her staff, to creating the program.

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102 Ed Skloot, (Surdna Foundation), interview with the author, April 13, 2007.

103 Lance Henderson, (Skoll Foundation), interview with the author, June 7, 2007.

104 Freund interview, March 3, 2007.

Until the staff succeeded in securing a foundation grant to help with program start-up, the initiative ran only on the existing salaries of public employees and the good will of community volunteers to test the idea.

Creating an Enabling Environment

In interviews, the researchers found that government has created an enabling environment for social entrepreneurs in a variety of ways—most prominently by removing barriers, lending credibility, and supporting collaboration. The examples discussed below show how government has succeeded in supporting social entrepreneurs through these practices.

At times, existing practices and systems present barriers to addressing a social problem with an innovative and entrepreneurial approach. "Social entrepreneurs are constantly pushing up against artificial barriers," says David Eisner, CEO of the Corporation for National and Community Service. "Teacher certification, social-service certification, volunteer-manager certification all end up preventing social entrepreneurship and limiting scale and innovation as it relates to solving the problem."[105] In these cases, as Ashoka Vice President Susan Davis has noted, government can play a crucial role in removing barriers to "offer an enabling environment to entrepreneurs." She says government is well positioned to identify and address "all barriers, particularly those created by government, that block or discourage people's entrepreneurship."[106]

In some cases, existing laws can constitute barriers to implementing new ideas. ITN*America*, for example, found that policy changes were essential to removing barriers to creating a viable transportation alternative for seniors. When the organization encountered problems accepting car donations—because of a Maine state law meant to protect consumers from unregulated used car dealers that limited the number of donated or traded cars they could accept—ITN*America* went to work on a bill that would make an exception for organizations serving the elderly. As a result of ITN*America*'s efforts, Maine's Act to Promote Access to Transportation for Seniors, sponsored by State Senator Michael Brennan, passed in 2005.[107] It provides an exemption from automobile dealership laws for any public or nonprofit organization that uses

105 Eisner interview, April 30, 2007.

106 Davis, *Social Entrepreneurship*, 12.

107 For details, see Maine State Legislature, *An Act to Promote Access to Transportation for Seniors*.

automobile donations to provide transportation to seniors, or that takes personal automobiles in trade from seniors in exchange for transportation services.

For several successful social entrepreneurs, government officials have helped them create an enabling environment simply by drawing attention and ultimately lending credibility to their causes. For example, First Lady Mikey L. Hoeven of North Dakota has made substance abuse one of her key issue areas, and a letter from her office to all of the public high schools in her state has generated a new market opportunity for Outside the Classroom. For ITN*America* and KaBOOM!, support from public officials—and particularly their attendance at events—has been helpful in generating media attention for their organizations. In addition, four of the social entrepreneurs interviewed—Jim Fructerman of Benetech, Katherine Freund of ITN*America*, Michael Brown of City Year, and Jon Schnur of New Leaders—have had opportunities to testify at federal congressional hearings regarding their social issue areas. Such opportunities both recognize them as leaders in their fields and allow them to influence the environments in which they operate.

For New Leaders for New Schools, local governments have created an enabling environment by helping to convene internal leaders and community stakeholders to support the initiative when it enters a new city. Both to ensure public, private, and community support and because the New Leaders financial model requires ongoing private sector funding, interested municipalities must convene external community leaders for fundraising and other types of community support. In its third year of operation, the New Leaders model has gained such credibility that it has begun hosting city competitions between municipalities in order to choose its next expansion site. The winning sites are those most able to demonstrate that they can create an enabling environment, marshalling city leaders, government resources, and engaged citizen groups who can demonstrate the interest and energy to develop New Leaders in their cities. New Leaders has now selected six of the nine cities in which it operates through this city competition process.

Rewarding Performance

Another powerful way government has supported the work of social entrepreneurs is by rewarding their performance through government financial support. As Howard Husock, director of the Manhattan Institute's Social

Entrepreneurship Initiative, points out, "Social entrepreneurs want access to reliable sources of financing that recognize performance."[108] Four of the organizations in the interview pool have received government support in the form of performance-based rewards, through funding and purchasing. These rewards, in turn, have further enabled these organizations to leverage public and private resources and develop solutions.

When social entrepreneurs' innovations begin to catch on, government can recognize their positive results and reward their performance by institutionalizing funding. For example, following RSVP's success in reducing recidivism among criminal offenders, San Francisco city managers established RSVP as a line item in the budget to ensure continued funding for the initiative even after private grant funding ran out. As discussed in the previous section, City Year also benefits from institutionalized funding, as one of 800 nonprofits to receive federal funding from the Americorps program that it also helped to inspire.

When social entrepreneurs produce and sell socially beneficial goods or services, another way government rewards performance is through purchasing their products. One of the single largest customers for the Arkenstone Reading Machine is the U.S. Department of Veterans Affairs (VA), which purchases the technology and distributes it to patients at VA hospitals. Similarly, Outside the Classroom's Web-based curriculum is sold to public universities across the nation. While CEO Brandon Busteed admits that private universities, which typically have greater discretion in their spending, were among the first to purchase the new technology, their positive results in reducing substance abuse and dropout rates have been rewarded with an expanding base of public university customers.

Scaling Success

Often, the best reward for successful performance in social entrepreneurship is having the chance to scale success. Expanding the reach of a proven solution in a situation of market failure is often critical if the solution is to be truly transformative. While for-profit companies can use an initial public offering (IPO) to secure the funds for the huge initial investment that scaling requires, there is no equivalent available to social entrepreneurs—who, even if they have developed a low-profit model, rarely operate within traditional

108 Howard Husock, (director, Manhattan Institute Social Entrepreneurship Initiative), interview with the author, May 9, 2007

profit margins to scale, let alone go public. As a result, in interviews, government often came up as the equivalent of an IPO that could help social entrepreneurs scale their approaches. As Jeff Bradach of the nonprofit consulting firm, the Bridgespan Group, explains, "While private funders will sometimes provide seed money to stimulate the development of local programs, they rarely supply the capital to build a network of sites. The one exception to this rule is the federal government, which sometimes supports the proliferation of successful programs."[109] For the social entrepreneurs discussed in the cases below, government at the federal, state, and local levels has played an important role in scaling their initiatives.

At the city level, government municipalities around the country have begun to hear about the quality of New Leaders' principals and the ease of working with New Leaders staff. Many now approach New Leaders with a desire to replicate the model. The demand has been so great that each time New Leaders has the capacity to expand they host a competitive "bidding" process. New Leaders now operates in nine cities.

In the case of ITN*America,* which started in Portland, Maine, scale has taken place in several ways. First, state legislatures and governors' offices have stepped forward with replication funds in Connecticut, New York, Utah, and Illinois, and state legislatures in Rhode Island[110] and Hawaii[111] have passed resolutions to plan for ITN replication or to support federal efforts for expansion. Second, the federal government has supported spreading information about the model. In 2000, Executive Director Katherine Freund was selected as a National Transit Institute Fellow, a program paid for by the federal government and administered by Rutgers University in New Jersey. She traveled to 13 states to share what she had learned in starting ITN*America*. Because of the federal support, many senior transportation programs have used ITN*America* learnings to improve their own services.

There may be a third way in which the ITN*America* model will be scaled, which could be seen as the equivalent of an IPO. In 2006, Senator Susan M. Collins from Maine introduced the Older Americans Sustainable Mobility

109 Bradach, "Going to Scale," 25.

110 Rhode Island State Legislature, *Requesting the Department of Elderly Affairs and the Advisory Commission on Aging to Study all Aspects of the Independent Transportation Network*.

111 Hawaii State Legislature, *Transportation for Senior Citizens and Visually Impaired Persons.*

Act of 2006 based on the ITN*America* model. As Collins stated in her Senate testimony, the legislation would "create a five-year demonstration project, overseen by the Administration on Aging, to establish a national, nonprofit senior transportation network to help provide some transportation alternatives to our aging population." This last example of scale shows how scaling at the federal level can end up having major benefits not only for the social entrepreneur whose innovation is replicated, but also for the government that can take up new solutions once they have been tested and honed by social entrepreneurs. In Collins' words: "The goal of this network is to build upon creative, successful models that are already showing how the transportation needs of older Americans can be met in a manner that is economically sustainable. This last point is important, Mr. President. Senior transportation is a complex and expensive logistical problem. We cannot expect to address this problem by creating a brand-new, expansive, federal government program that requires the commitment of vast sums year after year in order to succeed."[112]

City Year provides another example of how federal and city governments have supported scale. City Year received a critical federal grant in 1995, when the organization operated in just one city. The money allowed expansion into five additional cities over five years. In addition, City Year, as part of a larger coalition of advocates for national service, worked with elected federal policymakers to establish the Corporation for National and Community Service. One of the Corporation for National and Community Service's three core programs, AmeriCorps, is based on the City Year model and may be the best example of an IPO equivalent that succeeded in supporting a social entrepreneur in scaling their approach.

Producing Knowledge

Innovation most often requires making use of reliable information that can help to answer such questions as: What is the target social problem? How many people are affected? Are current or past activities effective in making changes? For this reason, successful social entrepreneurship is often closely associated with what Gregory Dees calls "market-like feedback mechanisms."[113] Government often plays a critical role as a resource and part-

112 Collins, "Introduction of the S. 2311: 'Older Americans Sustainable Mobility Act of 2006."

113 Dees, "The Meaning of 'Social Entrepreneurship,'" 6.

ner for producing knowledge that helps identify the problems, document the solutions, and compare various interventions against standards for success. Government specifically provides research data, establishes critical standards, and produces or funds evaluations that provide critical information for those working toward solving social problems.

For example, ITN*America*, Benetech, and KaBOOM! all have relied on government data and research to understand the nature of the social problems they are working to address. For ITN*America*, federally funded transportation studies revealed the safety concerns for older drivers that have become an essential part of justifying the need for ITN*America*'s service. Census data were also useful in predicting the growing size of the senior citizen population, and allowed for program planning. Benetech also relied on Census data to understand the prevalence of visual impairment in estimating the size of its customer base. For KaBOOM!, government tracking of playgrounds actually began after their initiative was well established. They regard the fact that the federal government now records the number of playgrounds as a sign of their program's influence. They use the government reports to gauge their own "market share" of playground development and the successful start-up of similar KaBOOM!-like organizations around the country.

Government data are important not only for problem identification but also for setting standards and gauging success. New Leaders uses government data as a central measure of program success. Student achievement is measured across the country using standardized, federally mandated tests. Federal standards allow New Leaders to compare the performance of students in schools led by their principals to students in non–New Leaders schools and in other similar districts. The federal data also allow New Leaders to gauge their own progress over time, assessing whether their initiative is taking deeper hold and whether they are influencing district-wide student performance gains. Because of government's role in producing clear, comparable standards, New Leaders and others working in the education field have detailed metrics that outline their path to success—metrics that are critical for their own evaluation, comparison to peers, and ultimately for knowing the social impact of their efforts.

Finally, for RSVP, government played a key role in producing knowledge directly about the program. Submitting their program to an independent, randomized evaluation study, RSVP has strong evidence of program effectiveness and was partially funded with public dollars.

Summary: How Government Supports Social-entrepreneurial Initiatives

Table 6.2 provides an overview of all eight case studies and government's five methods of involvement. Notably, while each of the case studies was supported by government in at least one of the five ways, none of the social entrepreneurs benefited from government in all five ways.

Conclusion

This chapter was developed to introduce government leaders to the field of social entrepreneurship. It also represents one of the first explorations of the relationship between social entrepreneurship and government. The eight case studies discussed here each showed a social-entrepreneurial initiative responding to some type of market failure—ranging from restoring prisoners to their communities to preventing drug and alcohol abuse on university campuses. Each of the organizations highlighted has developed transformative innovations—from technology to support the blind, to training and mentorship of high-school principals. They have built financially sustainable models, gaining efficiency by relying on volunteers, marrying their social problems to complementary private sector funding sources, convincing satisfied consumers to pay for services, and developing new markets to sell their products at profitable price points. All of their models have benefited both government and society as a result.

The previous sections of this chapter have also highlighted numerous ways in which government is already supporting social entrepreneurship in the United States. In fact, in many cases, the support of government leaders has been essential to social entrepreneurs' success. Yet, while each of the social entrepreneurs interviewed could point to at least one example of individualized government collaboration, all expressed an interest in a coordinated governmental approach to supporting and ultimately increasing the impact of social-entrepreneurial initiatives.

Interviews with social entrepreneurs and other experts in the field repeatedly suggested that there is good reason for government to begin thinking this way. First, social entrepreneurs have demonstrated remarkable success in advancing promising solutions to social problems that governments, too, seek to address. As College Summit Founder J. B. Schramm puts it, "Social

Table 6.2 Government Involvement with Social-Entrepreneurial Initiatives

	Method of government support				
Social entrepreneur	**Encouraging social innovation**	**Creating an enabling environment**	**Rewarding performance**	**Scaling success**	**Producing knowledge**
ITNAmerica	**Seed funding.** Three federal grants and a federal congressional designation of funds used to develop model.	**Breaking barriers.** State policy changes, facilitated car donations, support volunteers' car insurance. **Credibility.** Elected officials participate, lending recognition and media coverage, founder appointed by the president to the Advisory Committee for the White House Conference on Aging.		**Replication.** States and cities sign on as replication sites; federal legislation introduced to scale the ITN model nationally. Spread information. Federally sponsored fellowship provided founder with platform to visit 13 cities to encourage adoption of elements of the program.	**Research/data.** Government data help show safety of older drivers and predict size of elderly population.
City Year		**Credibility.** Elected officials frequently visit and champion initiative, founder testified to U.S. Congress.	**Funding.** Established initiative receives consistent federal grants to support model.	**Replication.** Federal grant allowed expansion to new cities. Federal government embraced national service model and established Corporation for National and Community Service and Americorps.	**Research/data.** Government reports on volunteerism statistics, cost savings of volunteers.
Benetech		**Credibility.** Founder testified to U.S. Congress.	**Purchasing.** Federal agencies purchase the reading machine.		**Research/data.** Government data assist in understanding customer base.
KaBOOM!		**Credibility.** Elected officials participate, lending recognition and media coverage.	**Purchasing.** Some city parks departments use in lieu of their own processes and purchasing.		**Research/data.** Government recently began collecting national statistics on playgrounds.

Table 6.2 Government Involvement with Social-Entrepreneurial Initiatives —continued

	Method of government support				
Social entrepreneur	**Encouraging social innovation**	**Creating an enabling environment**	**Rewarding performance**	**Scaling success**	**Producing knowledge**
New Leaders for New Schools		**Convening.** Cities unite internal staff and community leaders to support local New Leaders initiatives.		**Replication.** Once model was established, cities began to compete to be New Leaders sites.	**Standards.** Gauge success using federal measures of student performance.
Resolve to Stop the Violence Program	**Seed funding.** Initiative created by government staff and public resources.		**Funding.** Established initiative added to city budget, institutionalizing the approach.		**Evaluation.** Sponsored study of program effectiveness.
Outside the Classroom		**Credibility.** Endorsement by First Lady of North Dakota helped reach new customer base.	**Purchasing.** Public institutions of higher learning purchase the curriculum.		
TROSA	**Seed funding.** Low-interest loans and financing for residential facilities.		**Purchasing.** State contracts for services to prisoners.		

entrepreneurship offers government an opportunity to leverage its dollars much farther than ever before. Social entrepreneurs are on the ground. We're seeing and addressing problems two steps ahead of everyone else, and we can share what we know on Capitol Hill."[114] Second, as the current generation of social entrepreneurs seeks to further maximize their impact, they are finding over and over again that local, state, and federal governments hold the key to unlocking their full potential. As Skoll Foundation's Lance Henderson states, "A lot of people are talking about how public policy—through ideas like new organizational forms, new tax incentives, and other government policies—can be an important lever for change."[115]

Three brand new initiatives that cropped up during the writing of this chapter, summarized in Table 6.3, have provided evidence that not only social entrepreneurs are looking for ways for government to join forces with social-entrepreneurial initiatives. Government, too, has begun to seek opportunities to join forces strategically with social entrepreneurs:

Louisiana's Office of Social Entrepreneurship

Following the devastation of Hurricanes Katrina and Rita, Louisiana Lieutenant Governor Mitch Landrieu and his office have been determined to find inspired solutions to the myriad problems facing the state. The unprecedented needs associated with rebuilding have amplified already intense demands on the state's social service system. Simultaneously, the unprecedented flow of emergency funds and philanthropic support to the region has created new opportunities—but with strong demands to see meaningful results.[116]

Early in 2007, Landrieu founded the first ever Office of Social Entrepreneurship, which aims to shift the orientation of the social-services sector of the state to a results-driven approach, and designates the city of New Orleans as a "Social Entrepreneurship Empowerment Zone," with the intention of making it "the most hospitable place in the country for those who are testing and launching the best, most effective new program models for social change."[117]

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114 J. B. Schramm, (founder, College Summit), interview with authors, June 4, 2007.

115 Henderson interview, June 7, 2007.

116 Landrieu, keynote address, New York University Stern School of Business Berkeley Center for Entrepreneurial Studies Fourth Annual Conference of Social Entrepreneurs, April 13, 2007.

117 Ibid.

Table 6.3 Recent Government Support of Social Entrepreneurship	
2007 Social entrepreneurship and government initiatives	**Overview**
Louisiana's Office of Social Entrepreneurship	The first-ever governmental Office of Social Entrepreneurship in the United States aims to shift the orientation of social services in the states to a results-driven approach, and designates the city of New Orleans as a Social Entrepreneurship Empowerment Zone.
North Carolina Low-profit Limited Liability Partnership Company (L3C)	This legislation would create a new organizational identity—a low-profit limited liability partnership company (L3C). L3Cs would operate as private enterprises, but with charitable or educational purposes, no significant purpose of income or appreciation of property, and no express political or legislative advocacy mission. The primary purpose would be to allow socially motivated profit-making partnerships to gain access to philanthropic funds through a little-used but already established vehicle called program-related investments (PRIs).
Girl Scouts of the USA Challenge and Change	Funded by the U.S. Department of Agriculture, this program is currently being piloted with teen girls in 22 communities across the country. It focuses on teaching social entrepreneurship to girls in rural areas, beginning with a five-day retreat where they learn leadership, problem solving, and entrepreneurial skills.

North Carolina's Low-Profit, Limited Liability Partnership Company (L3C)

Also in early 2007, in North Carolina, State Senator Jim Jacumin introduced legislation that would create a new organizational identity: a low-profit, limited liability partnership company (L3C). Developed by the Mary Elizabeth & Gordon B. Mannweiler Foundation CEO Robert Lang—with help from Marcus Owens, a partner in Caplin & Drysdale and former head of the Exempt Organization Division of the IRS—L3C is an organizational type that recognizes the unique blending of the three sectors. L3Cs operate as private enterprises, yet must have charitable or educational purposes, no significant purpose of income or appreciation of property, and no express political or legislative advocacy mission.[118] The primary purpose of the L3C is to allow profit-making partnerships to nonetheless gain access to philanthropic funds, through a little-used but already established vehicle called Program Related

118 To be designated an L3C, an organization must satisfy the following requirements: (1) the entity significantly furthers the accomplishment of one or more charitable or educational purposes within the meaning of section 170(c)(2)(B) of the Internal Revenue Code of 1986, as amended, and would not have been formed but for the entity's relationship to the accomplishment of charitable or educational purposes; (2) No significant purpose of the entity is the production of income or the appreciation of property; provided, however, that the fact that an entity produces significant income or capital appreciation shall not, in the absence of other factors, be conclusive evidence of a significant purpose involving the production of income or the appreciation of property; and (3) No purpose of the entity is to accomplish one or more political or legislative purposes within the meaning of section 170(c)(2)(D) of the Code, as amended.

Investments or PRIs.[119] Establishing the L3C would also give low-profit-market social entrepreneurship in North Carolina the added recognition and credibility of a new, distinctive organizational form.[120]

Girl Scouts of the USA's Challenge and Change: Challenge Yourself, Change the World

In 2006 the U.S. Department of Agriculture provided funding to the Girl Scouts of the USA to develop a new national program to strengthen rural communities through teen leadership. The program was developed through a unique collaboration between the Learning Innovation and Technology Consortium and Girl Scouts of the USA. The program "Challenge and Change: Challenge Yourself, Change the World" teaches teenage girls how to become social entrepreneurs, and it has been implemented in more than 20 states. It begins with a five-day retreat where girls learn leadership, problem-solving, and entrepreneurial skills through a comprehensive multi-media curriculum. They learn to apply the strategies of successful social entrepreneurs by watching and analyzing social entrepreneurs in action, including those profiled in *The New Heroes*, a PBS documentary series about social entrepreneurs from around the world. To bring the topic closer to home, girls also take field trips to meet social entrepreneurs in their own local communities. Challenge and Change teaches girls skills that will help them to identify community problems, recognize and build on local assets, design sustainable solutions, and implement their own action plans.

As social entrepreneurship begins to capture the attention of policy makers, the research here also suggests a number of levers that could guide government in further efforts to strategically support social entrepreneurship, in addition to the examples provided by the initiatives described above. These include certification programs like the U.S. Small Business Administration's initiative focused on promoting business within Historically Underutilized Business Zones, or HUBZones.[121] As City Year Co-Founder Alan Khazei has pointed out, this type of program could serve as a model for encouraging

119 Lang, "Charitable Returns."

120 The "branded" L3C would also provide a basis for the issuance of commercial paper that could be sold to a wide variety of investors, as foundations (under PRI rules) would absorb the highest level of risk, making the remaining investment tranches attractive to additional investors at attractive rates of return.

121 U.S. Small Business Administration, "HUBZone," https://eweb1.sba.gov/hubzone/internet/general/whoweare.cfm#3.

social entrepreneurs to scale their approaches in historically difficult areas: "Government could help to bring high-performing social entrepreneurs to needy areas by establishing a special matching fund: social entrepreneurs who choose to operate in targeted areas would be eligible for additional funding, for example, matching two to one the funds raised privately."[122] Another potential lever is the reallocation of public financing, as exemplified by the use of public funding to encourage the development of charter schools that exercise increased autonomy in their programming, in exchange for increased accountability in terms of academic results and fiscal practices. According to Chris Gabrieli, 2006 Massachusetts gubernatorial candidate and chairman of the education think tank, Mass2020, "Charter school policy opened the door for literally hundreds of social entrepreneurs to try their hands at making a difference on the achievement gap. It has created thousands of schools, ranging from extraordinary successes through mediocrity down to abject failures, with experimentation and learning all along the spectrum."[123]

Finally, government could look to recent growth-fund approaches that have developed proven methodologies for scaling the success of social entrepreneurs that government could learn from and participate in. In the last decade, two such approaches to fund for-profit and nonprofit social entrepreneurs have emerged. The first, sometimes referred to as venture or engaged philanthropy, combines grant making and management assistance for nonprofit social entrepreneurs, while the second, sometimes called social venture capital, makes debt and equity investments to for-profit organizations acting on what this chapter calls low-profit-market opportunities.[124] Both approaches borrow heavily from the private sector's venture-capital practices, where initial investment decisions are typically measured against the organization's past history and a business plan that describes the next three to five years of growth, with clear indicators to measure success.

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122 Alan Khazei, (co-founder, City Year), interview with the author, May 29, 2007.

123 Chris Gabrieli, (chairman, Mass2020), interview with author, June 11, 2007.

124 Some of the venture-philanthropy groups best known for this new approach that government could learn from and work with include Atlantic Philanthropies, Edna McConnell Clark Foundation, New Profit Inc., Robin Hood. Foundation, Roberts Enterprise Development Fund, the Skoll Foundation, Venture Philanthropy Partners, and the Wallace Foundation. Some of the best known social venture capital groups include Acumen Fund, Good Capital, Investors Circle, and the New Schools Venture Fund; the last one actually provides both grants and investment to nonprofits and for-profits in the education sector. More recently, super-growth funds have emerged attempting to raise tens of millions of dollars for social entrepreneurs much like investment banks for private companies, including Sea Change Capital, started by former Goldman Sachs executives, and Growth Philanthropy Capital.

The early examples of government support for social entrepreneurship—along with the additional levers available to policymakers—suggest that government support of social entrepreneurship has the potential to be as diverse and innovative as the field itself. At the same time, the nonprofit sector is beginning to find new and innovative ways to collaborate with government in supporting social entrepreneurship. The Aspen Institute, most recently with the help of the Social Enterprise Alliance, has convened several meetings aimed at exploring new organizational forms that policymakers could create. Harvard University's Initiative on Social Enterprise has also held a meeting on this topic. Another recent initiative from within the nonprofit sector is New Profit, Inc.'s Action Tank, launched in 2006 to develop, pilot, and promote new nonpartisan approaches to public problem solving that tap the principles and results of social entrepreneurship to create broad-scale social change. The Action Tank seeks to play a leadership role in closing the gap between policymakers and social entrepreneurs at the local, state, and federal levels.

These new initiatives constitute the first wave of what is likely to be a flood of new experiments in governmental support of social entrepreneurship—as that support on the local, state, and federal levels transitions from one of occasional, one-time support to a strategic, long-term strategy for leveraging the successes of social entrepreneurs into enduring solutions for the nation's most pressing social problems. Government leaders and social entrepreneurs have an opportunity to generate enormous social benefit, if they can find ways to work in true strategic partnership. Americans may already be witnessing the beginnings of what City Year Co-Founder Alan Khazei calls "a new role for government in the 21st century. Increasingly, government will be working in partnership with the other two sectors, and, in particular, leveraging social entrepreneurs."[125]

125 Khazei interview, May 29, 2007.

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7 Pre-venture Planning

Synopsis

In any given year, approximately 7 percent of the working age population in the United States is actively engaged in efforts to start new businesses.[1] Usually, within a period of two years, about a third of all these entrepreneurial efforts will either result in the creation of new businesses (approximately six million new businesses), or not.[2] Given the millions of people involved in starting businesses, as well as the billions of dollars they invest in the entrepreneurial process, insights into ways that entrepreneurs could improve their chances of business success, as well as minimize their losses for opportunities that are not viable, would have important benefits. There is much anecdotal speculation that writing a business plan is a critical activity for enhancing entrepreneurial successes and minimizing failures. But does writing a business plan actually provide the benefits suggested?

Professors William B. Gartner and Jainwen (Jon) Liao provide compelling evidence that engaging in business planning can significantly improve an entrepreneur's chances of successfully starting a business. They base their findings on research from a unique survey of people in the process of starting businesses in the United States: the Panel Study of Entrepreneurial Dynamics (PSED). The PSED surveyed 64,622 working age adults to identify a sample of 830 individuals who were currently in the process of starting businesses. These individuals were surveyed each year over a three-year time frame to identify the kinds of activities these entrepreneurs undertook and whether their efforts resulted in the creation of new businesses. By finding individuals in the process of starting new businesses, the PSED avoids a common problem with many studies that analyze only businesses that were successfully started: survivor bias. The PSED has information about both

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1 This chapter was prepared under contract with the U.S. Small Business Administration, Office of Advocacy, by William B. Gartner, Spiro Professor of Entrepreneurial Leadership, Clemson University, and Jianwen (Jon) Liao, Associate Professor of Strategy and Entrepreneurship, Illinois Institute of Technology. The views presented here are those of the authors and not of the U.S. Small Business Administration or the Office of Advocacy.

2 Reynolds, P. D., 2007.

entrepreneurs who started businesses and those who quit the process or who are "still trying" to create a business. Comparing successes with failures reveals true contrasts about what activities lead to entrepreneurial success.

The authors survey previous research on the usefulness of business planning that has employed the PSED or datasets developed with methods and questionnaires similar to the PSED. Previous research shows that business planning significantly enhances the chances that an entrepreneur will start a new business. The authors describe how the PSED was constructed, and how it might be used to explore the entrepreneurial process, and find the following:

- Entrepreneurs who started businesses were more likely to complete a business plan than entrepreneurs who were "still active"—still in the process of starting the business—or had quit the process.
- Entrepreneurs who completed a business plan were six times more likely to start a business than those in the "still active" or "quit the process" groups.
- Entrepreneurs who completed written business plans were more likely to start a business than entrepreneurs in the two other groups.
- Entrepreneurs who completed a business plan were more likely to engage in more start-up activities than those in the two other groups.
- Entrepreneurs who completed written business plans were more likely to engage in more start-up activities than entrepreneurs who completed less formal plans (unwritten or informally written).
- Entrepreneurs who contacted and participated in government-sponsored entrepreneurship programs were five times more likely to start a business than entrepreneurs in the two other groups.

Overall, these results suggest that entrepreneurs should engage in business planning during the start-up of their businesses and that they should write a formal business plan. Entrepreneurs who planned and wrote formal business plans were more likely to create a new business than others. Planning matters!

Introduction

A wide variety of methods are used to encourage entrepreneurs to develop business plans during the process of developing their new ventures.[3] But do efforts to create business plans improve the chances of starting a new business?

The authors explore whether business planning is helpful in creating new ventures using a unique dataset, the Panel Study of Entrepreneurial Dynamics (PSED). The PSED identified and tracked, over a five-year period, a sample of entrepreneurs in the process of starting businesses, thereby solving a major problem in many studies of entrepreneurs: "survivor bias." Survivor bias results when a study observes only successful firms—those that survived—excluding any of the businesses that failed. Understanding success requires knowledge of failures. Studying a sample of all entrepreneurs in the process of starting a business enables comparisons between entrepreneurs who successfully started new businesses and those who gave up. The ability to compare and contrast differences among the successes and the "failures" allows researchers using the PSED to generate important insights into the activities that truly influence business creation success.

This project answers a number of questions about the value of planning for starting new businesses:

- Does business planning improve the chances of starting a new business?
- Do more formal business plans (i.e., written plans) improve the chances of starting a new business?
- When should business planning occur during the venture creation process to improve the chances of starting a new business?
- Is business planning a signal that entrepreneurs are engaged in other start-up activities—doing, rather than thinking about starting a new business?

The authors also explored whether entrepreneurs who contact various types of business assistance programs or take classes or workshops on the

3 Examples would include the U.S. Small Business Administration's support of small business development centers, SCORE, and women's business centers; public/private partnerships like the Kauffman Foundation's *FastTrack* program; and university-based activities involving business plan classes and competitions.

topic of starting a business are more likely to engage in business planning, and whether they are more likely to succeed at getting into business.

The chapter is divided into four sections. The first section briefly reviews prior research on the value of planning for success at creating new ventures. The second describes the unique and useful features of the Panel Study of Entrepreneurial Dynamics (PSED) and other spinoffs of this research program for exploring issues involved with new venture creation. The third lays out the ways data from the PSED were analyzed and reports the findings from these analyses. The final section discusses the limitations of using quantitative datasets like the PSED for understanding the process of business planning and then offers some insights into how the results of this study might have implications for public policy and training.

The Value of Pre-venture Planning

Literature from seasoned entrepreneurs, advisors, investors, and academics suggests that entrepreneurs should engage in business planning during the process of venture creation as a way to guide them toward activities useful for starting new firms.[4] While there has been some concern about devoting too much time to business planning or making the business planning process too sophisticated,[5] there is a strong belief that it is better to engage in some type of planning in the business creation process. Yet Bhide (2000) suggests that taking action to develop the business is more important than completing a business plan.[6] This section explores some of the reasons and evidence for the value of business planning as well as arguments for why engaging in planning might be less helpful for starting a business.

Why Plan?

Frederic Delmar and Scott Shane (2003) offer four reasons why entrepreneurs should engage in planning during the process of venture creation. They suggest that planning helps individuals develop a framework and context for taking action so that individuals can: (1) quickly identify what they do not know, (2) understand what resources they need and when these resources

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4 See, for example, Abrams, 2003; Ford, Bornstein, Pruitt, Ernst & Young, 2007; Timmons, Zacharakis, Spinelli, 2004.

5 Bhide, 1994; Gumpert, 2002.

6 Bhide, 2000.

might be utilized, (3) identify specific actions that can help solve problems and attain goals, and (4) help communicate to others the purposes, objectives, and activities necessary to achieve venture success.[7]

Entrepreneurs who develop a plan become conscious of their assumptions about how their proposed new business will succeed. Assumptions about the ability of the new firm to be profitable, the resources necessary to start and operate the firm, the knowledge necessary to provide products and services in a timely and cost-effective manner, and the number of potential customers are a few of many issues entrepreneurs consider when planning. By surfacing these assumptions, entrepreneurs can test their beliefs, rather than invest time and resources in actions that may have little chance of succeeding. Planning, therefore, can save time and money in the venture creation process.[8]

Planning can also reduce the likelihood of delays in organizing the new venture, acquiring plant and equipment, and producing goods or providing services. Planning can help an entrepreneur identify when key resources (such as inventory, equipment, licenses and permits, and trained personnel) will likely be needed during the business creation process, thereby saving time and money.[9]

Planning can help entrepreneurs identify specific actions they will need to take to achieve their goals.[10] By identifying specific actions, entrepreneurs can focus their efforts, as well as realize when their efforts are not producing their desired goals. Planning, therefore, keeps individuals on track by channeling their energy and providing benchmarks.[11]

Finally, planning helps entrepreneurs communicate their vision to others, enabling the emerging venture to gain support and resources.[12] By having a plan, entrepreneurs can enlist potential investors, suppliers, customers, and employees to become involved in the new venture. A business plan also represents a form of "legitimacy," in that entrepreneurs who have a plan are likely to be seen by others as individuals who have knowledge of the require-

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7 Ansoff, 1991; Locke and Latham, 1980.

8 Armstrong, 1982.

9 Armstrong, 1982; Bracker, Keats, and Pearson, 1988.

10 Locke and Latham, 1980.

11 Robinson, 1984; Schrader, Taylor, and Dalton, 1984.

12 Bird, 1992.

ments for business success, rather than "dreamers" who are unaware of potential pitfalls in the start-up process.[13]

Reasons for Not Planning

A number of reasons are offered for why entrepreneurs may not benefit from business planning. First, the process of business creation for new and radically innovative companies may be so unpredictable and uncertain that planning might not help to identify critical contingencies and options. Matthews and Scott (1995) suggested that entrepreneurs who perceive highly uncertain environments may be less likely to engage in planning because they believe that planning efforts will not provide any information that can be usefully acted upon.[14] They found that as the perceptions of uncertainty for how business success might be achieved in particular environments increased for entrepreneurs, they were less likely to engage in business planning.

Second, entrepreneurs construct their businesses through action, and action makes the new venture apparent to entrepreneurs and others. For example, Baker and Nelson (2005) identified entrepreneurs whom they identified as "bricoleurs"—individuals who would "make do with whatever was at hand."[15] These bricoleurs created the necessary resources for venture development and growth rather than be bound by perceived environmental constraints. They suggest that entrepreneurs construct their businesses and environments through action:

> The bricoleurs in our study did not view opportunities as objective and external to the resources and activities of the firm. Rather, the processes of discovering opportunities and enacting resources were often one and the same, with both the resource environment and the opportunity environment idiosyncratic to the specific firm and constructed through processes of bricolage.[16]

Baker and Nelson (2005) make a case that action is necessary for people to make sense of what occurs in their lives. This implies that planning before taking action to explore the environment (certain or uncertain) would be pre-

13 Delmar and Shane, 2004; Honig and Karlsson, 2004.

14 Matthews and Scott, 1995.

15 Baker and Nelson, 2005: 330.

16 Ibid, 358.

mature.[17] In this perspective, entrepreneurs may only know what their goals and objectives are once they have taken action to see what goals and objectives might be viable.

Finally, the process of planning takes time, effort, and resources that could be used to engage in activities that might be more helpful for the creation of the new business. For example, Carter, Gartner and Reynolds suggest that:

> Behavior such as buying facilities and equipment might be a more significant indicator to others that a nascent business is real than undertaking a behavior such as planning. Buying facilities may show others that the entrepreneur has made a significant commitment to creating a new business compared to what might be a less public demonstration of commitment like planning.[18]

Planning, then, might be a distraction from taking the necessary actions to create a business. Entrepreneurs might experience "analysis paralysis" distracting themselves with the process of planning, rather than taking actions to secure customers, acquire resources, hire employees, or undertake other tasks to make the business a reality.

Evidence About Pre-Venture Planning

A major problem in the search for research on the value of planning for creating new ventures is that most studies have not actually looked at new business creation. For example, Bhide (2000) uses as his primary source of data, businesses on the *Inc.* magazine list of the 500 fastest growing private firms in the United States. His sample consists of already established firms, and only firms that have high rates of sales growth; there are no failures and no low-growth firms either, to compare with the high-sales-growth firms. A study that looks only at successful firms is likely to have survivor bias. Over a period of time, many firms would have failed, and the failures would not be accounted for in a register of the survivors to be studied.

A study of reasons for the success of businesses requires that they be compared with businesses that are not successful. A study that looks only at successes may be based on an untested assumption that the failed firms

17 Weick, 1979.

18 Carter, Gartner, and Reynolds, 1996: 154.

are not like the successes. So, for example, if successful firms had founders that invested their personal resources in the new ventures, one might assume that the unsuccessful firms had founders that did not invest their personal resources. Without knowing whether the failed firms had investments from their founders, it is impossible to make this assumption; all of the failed firms could also have had such investments, and the founders' personal investment could be an irrelevant factor in the success. Any study of successful firms, then, needs to account for their differences from failed firms.

The number of research studies that have compared entrepreneurs who have successfully created new firms with those who have failed at this process is very small. Indeed, the studies that have looked at planning and its influence on new venture creation rely on either the Panel Study of Entrepreneurial Dynamics[19] or data collection methods and questions based on the PSED.[20] Table 7.1 lists the studies that have focused on planning during the process of business creation, the sizes of the samples used, and highlights of the findings about the value of planning and success at getting into business.

These studies strongly suggest that planning matters, with Honig and Karlsson finding a nearly significant result.[21] Entrepreneurs who complete a business plan are more likely to either continue in the business start-up process or actually start a business than are individuals who do not plan.

A number of other factors influence whether entrepreneurs will be successful in the venture creation process. For example, Delmar and Shane (2003) suggest that the nature of the opportunity pursued by entrepreneurs has a more significant effect on success than the act of planning itself, although in terms of actions that an entrepreneur can take, planning is the most important activity to engage in. Liao and Gartner (2006) found that entrepreneurs who were more uncertain about their chances of financing their businesses and their understanding of the competitive dynamics of their industries were more likely to be successful if they planned early in the start-up process, rather than later. Shane and Delmar (2004) found that entrepreneurs who completed business plans before engaging in efforts to talk

19 Liao and Gartner, 2006; Reynolds, 2007.

20 Delmar and Shane, 2003, 2004; Honig and Karlsson, 2004; Shane and Delmar, 2004.

21 Honig and Karlsson, 2004.

Table 7.1 Previous Research on Business Planning and Success at Starting a Business

Study	Sample size	Method of analysis	Findings on planning
Delmar & Shane, 2003	Sweden PSED: 223	Event history: A hazard function of disbanding	Entrepreneurs who engaged in business planning were less likely to quit the venture creation process during a three-year time frame. Entrepreneurs who engaged in business planning were more likely to increase product development and the number of venture start-up activities. Entrepreneurs with prior start-up experience were less likely to quit the venture creation process. The type of opportunity pursued significantly affected survival.
Delmar & Shane, 2004	Sweden PSED: 223	Event history: A hazard function of disbanding	Entrepreneurs who engaged in business planning and formed a legal entity were less likely to quit the venture creation process during a three-year time frame, and more likely to complete product development, initiate marketing efforts, and obtain inputs.
Honig & Karlsson, 2004	Sweden PSED: 396	Logistical regression on persistence in the start-up process	A nearly significant result ($p < .10$) that entrepreneurs who engaged in business planning were likely to continue in the start-up process (survive). Being a member of a business network, knowing the customer before start-up, and being a manufacturing start-up increased the likelihood of survival by factors of 4.4, 2.7 and 4.0, respectively.
Liao & Gartner, 2006	PSED: 276	Event history: A hazard function of disbanding	Entrepreneurs who engaged in business planning were less likely to quit the venture creation process during a two-year time frame. Entrepreneurs who initiated business plans: early in uncertain competitive and financial environments; and late in certain competitive and financial environments were less likely to quit.
Reynolds, 2007	PSED: 648	Comparison of means (F- test) and cross tabulations (chi-square)	Planning, as a part of a factor that describes the process of developing an organizational and financial structure, along with a variety of human capital (e.g., years of industry, work and managerial experience) and entrepreneurial activities (e.g., total hours and funds invested, contact with helping programs), is more likely to predict success at getting into business.
Shane & Delmar, 2004	Sweden PSED: 223	Event history: A hazard function of disbanding	When entrepreneurs engaged in business planning before talking to customers and initiating marketing and promotion efforts, the "hazard of termination" was reduced by 46 percent and 41 percent, respectively. Each prior start-up by the founding team reduced the hazard of termination by 24 percent. Each additional organizing activity reduced the hazard of termination by 25 percent.

to customers and in marketing and promotion were more likely to continue their start-up efforts (i.e., not quit).

Overall, it would seem that completing a business plan helps enable entrepreneurs to successfully create new businesses. Despite differences in the sample sizes used from each of the two major samples (the U.S. and Swedish PSEDs),[22] in how measures were constructed to indicate planning and success in getting into business, and in analytical techniques used to evaluate the data, the results seem to be fairly robust: business planning is an important activity that significantly correlates with creating new ventures.

All of the planning, activity, and outcomes measures used in these studies are broad representations of what individuals actually do when they are involved in starting businesses. The data on business planning and other start-up activities (see Tables 7.2, 7.3, and 7.4) reflect entrepreneurs' subjective reports based on what business planning (or any other activity) means to them. For example, written business plans vary in comprehensiveness and thoroughness; not known are the quality differences among the various written business plans. A written business plan may be 10 pages or 100 pages, may have a detailed analysis of competitors or not, may provide quarterly financial pro formas or not, etc. The quality of the business plan may also reflect the amount of time and effort entrepreneurs have undertaken to develop their business. But the measures used do not provide many details of what entrepreneurs actually did when they completed their business plans. Little information is available about why these business plans were undertaken (or not), or about the purposes for which these business plans were used during the start-up process.

Because all of these studies used the PSED dataset or data from Sweden that used techniques and questions similar to the PSED, the next section of this chapter provides details on how the PSED sample was created, and why it can provide findings with implications generalizable to all entrepreneurs.

The Panel Study of Entrepreneurial Dynamics[23]

The primary problem in studying the new venture creation process is that it is both difficult and expensive to find individuals when they are actually

22 A detailed description of the Sweden PSED can be found in Davidsson and Henrekson, 2002.

23 The section on the PSED is from Reynolds, Carter, Gartner, Greene, and Cox, 2002, and is used with permission.

involved in business start-up activities. On average each year, 5 to 10 of every 100 working-age adults are actively engaged in trying to start new businesses in the United States (Reynolds, Carter, Gartner & Greene, 2004). Conducting a random phone survey to find these 5 to 10 individuals would entail contacting 90 to 95 people not involved in starting a business. Locating a sufficient sample size of entrepreneurs, then, is expensive: most of the funding would be spent contacting non-entrepreneurs. In addition, persuading individuals who are contacted to participate in lengthy and detailed responses to questionnaires is expensive and difficult.

The Panel Study of Entrepreneurial Dynamics (PSED) solved this expensive problem of locating and systematically tracking a cohort of individuals *as they progressed* through the start-up process. It was the first attempt to develop a comprehensive representative portrait of entrepreneurial activity in the United States by studying this critical phenomenon and the people central to it in real time, rather than after the fact.[24]

More than 120 scholars participated in designing and implementing the research program, and 35 institutions—universities, nongovernmental organizations, private foundations, and government agencies (including the National Science Foundation and the U.S. Small Business Administration's Office of Advocacy)—invested more than $2.5 million in this project (with most of the funding coming from a series of Ewing Marion Kauffman Foundation grants).[25]

The PSED Model and Research Design

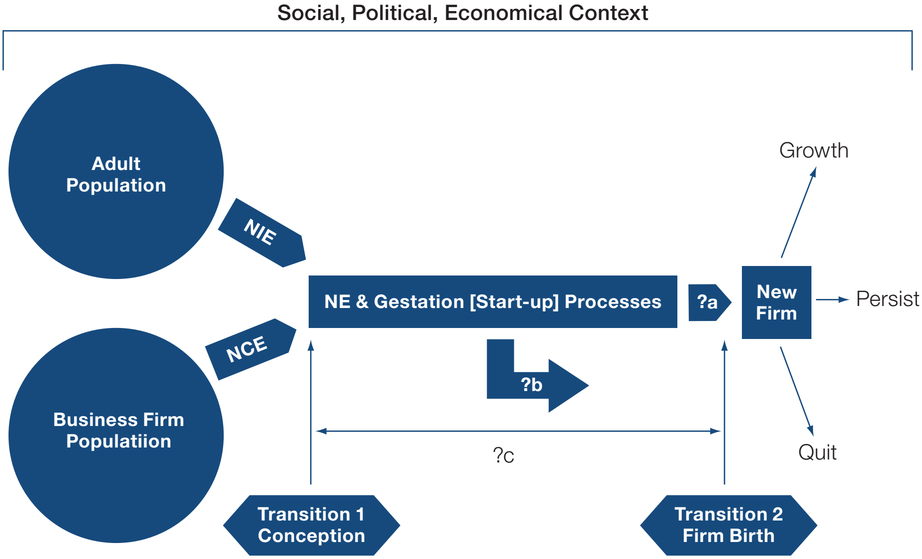
The PSED research program provides systematic, reliable, and generalizable data on important features of the start-up process in the United States.[26] Included is information on the proportion and characteristics of the American adult population involved in efforts to start firms, the activities that

24 The PSED process built on earlier efforts by Paul Reynolds and colleagues to study nascent entrepreneurs in Wisconsin (Reynolds and White, 1993; 1997), as well as a small national sample of nascent entrepreneurs who were identified from a study that was "piggy-backed" onto the University of Michigan Institute for Social Research Survey of Consumer Attitudes (Curtin, 1982; Reynolds, 1997). These prior studies indicated that it was technically feasible, as well as financially possible, to locate and survey individuals from the general population of all United States adults who were actively engaged in starting businesses.

25 A list of all those involved in the funding of this project can be found in the *Handbook of Entrepreneurial Dynamics* (Gartner, Shaver, Carter, and Reynolds, 2004, xxvi).

26 This report is an overview of a broader research program focusing on the general features of the entrepreneurial process that is described in detail in Reynolds, 2000.

Figure 7.1 Conceptualization of the Entrepreneurial Process



constitute the start-up process, and the proportion and characteristics of the start-up efforts that become new firms. A number of factors likely influence a person's decision to engage and persist in efforts to start a new business. Figure 7.1 presents a conceptual model of the start-up process that guided development of the PSED. The model accounts for the influence of political, social, and economic factors that continually affect the entrepreneurial process and depicts three stages with two transition points.

As illustrated on the left side of the model, the first stage of the start-up process involves the population of all adult individuals. These individuals come from two potential sources, the adult population at large and those currently employed in existing businesses.

Start-up Stages

Conception

The first transition point in the model, conception, signifies when individuals from these two sources choose to pursue a new business start-up. Individuals in the start-up phase who intend an independent start-up are considered nascent independent entrepreneurs (NIE). Those sponsored by an existing business are nascent corporate entrepreneurs (NCE). Both groups are referred to as nascent entrepreneurs (NE). The primary concerns at conception include the following: (1) determining the tendency of individuals to begin the business start-up process; and (2) determining the uniqueness of the individuals or their situation that leads some to enter this transition. The issues underlying conception are related to whether entrepreneurs are different from other individuals in the general population.

Gestation

The second stage of the entrepreneurial process, gestation, encompasses bringing businesses into existence. The detailed emphasis the PSED puts on this stage distinguishes this research program from other efforts. In gestation, the focus is on activities that nascent entrepreneurs undertake to get the start-up launched, as well as the length of time involved in these start-up efforts. The amounts and types of resources invested during the start-up process are of interest, as are questions regarding the composition and characteristics of the individuals involved. The model recognizes three pathways emerging ventures might take through gestation: (1) the nascent entrepreneur creates a new firm;[27] (2) the nascent entrepreneur is "still trying" to start the business; and (3) the nascent entrepreneur "gives up" and abandons the start-up effort. In essence, the gestation stage encompasses questions about how nascent entrepreneurs go about the process of starting firms.

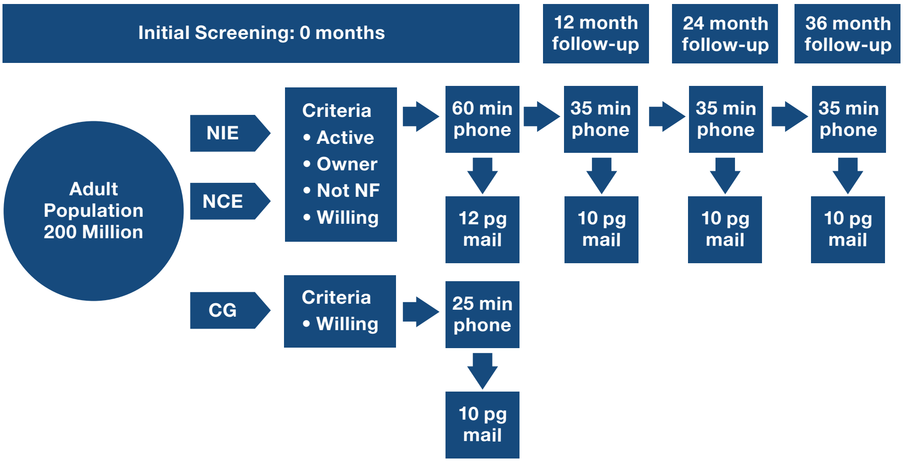
Birth and Infancy

The second transition point in the entrepreneurial process model represents the outcome of gestation, birth, when entrepreneurial activities lead to an infant business. Relative to this transition point, the model asks: Why do some of the business start-up efforts succeed in creating new firms? When a firm birth occurs, the new business transitions into the infancy stage, in which many new firms struggle through a "liability of newness," a time when the firm's very survival may be at risk. During infancy, three types of trajectories are possible: growth, persistent but stable survival, or termination.

PSED data make possible the study of the gestation, birth, and infancy process over time to determine how the nature of the individuals, their gesta-

27 A number of measures can be used to define a new firm. In most PSED studies, the start-up status variable (R502, S502, T502) "How would you describe the current status of this business?"—a self-reported measure—is used to determine whether or not a new firm exists. Other new firm indicators, such as receiving money or fees, achieving positive cash flow, filing federal taxes, or paying FICA, can be used to measure the existence of a new firm. See Table 7.2.

Figure 7.2 Research Design Overview



Notes: NIE=nascent independent entrepreneur; NCE=nascent corporate entrepreneur; CG=comparison group; NF=new firm.

tion strategies, and the context of the start-up affect future development of the new firm.

Data Collection

To collect data appropriate for testing the conceptual model in Figure 7.1 a methodology was developed giving importance to (1) a procedure for identifying and interviewing nascent entrepreneurs and a comparison group; and (2) the content of the interviews (Figure 7.2). The first stage in identifying and interviewing nascent entrepreneurs involved large-scale screening of households to create two samples representative of the national population of adults, those 18 years and older. First, a sample of individuals attempting to start a new business was identified—either nascent independent entrepreneurs (NIE) or nascent corporate entrepreneurs (NCE). Second, a representative sample of typical adults not involved with a business start-up was selected as a comparison group (CG). The comparison group is critical for comparing the tendencies and characteristics of the nascent entrepreneurs and generalizing the findings to a representative group of typical adults in the U.S. population. Once the screening procedures identified individuals for the two samples, detailed phone interviews were administered, followed by completion of self-administered questionnaires mailed to respondents. The third stage involved follow-up interviews with the nascent entrepreneurs 12, 24, and 36 months after their first interview.

In the screening phase of the data collection, a total of 64,622 individuals were contacted by telephone using a random digit dialing process to locate households with listed and unlisted numbers.[28] All screening interviews were completed between July 1998 and January 2000. The subsequent detailed interviews to the two samples covered a wide range of topics. Nascent entrepreneurs completed a phone interview that averaged 60 minutes in length, with a range of 35 to 90 minutes. A similar procedure was followed with the comparison group, except that only a randomly selected subset of respondents was taken from those who volunteered during the national screening. The phone interview with respondents in the comparison group took about 25 minutes to complete.

At the completion of the phone interview, all respondents—the nascent entrepreneurs and the comparison group—were asked if they would be willing to complete a brief (12- or 10-page) self-administered mail questionnaire. Ninety-eight percent agreed, and 68 percent of the nascent entrepreneurs and 77 percent of the comparison group respondents returned the mail questionnaires.[29]

The PSED Datasets

Two major PSED datasets are available for scholars to analyze and study.[30] The first dataset is known as the Screener. The Screener contains information on all 64,622 individuals that were contacted by telephone. The interviews provided information on 14 socio-demographic variables relative to the individual and household, including the county and state where the individual is located. Having information on these variables allowed a large number of county-related variables to be added to the records from other data sources (e.g., Census data). The Screener is useful for providing information on broad demographic variables for both the nascent entrepreneurs and for individuals and their households in the comparison group who indicated they were not involved in business start-up activities. This dataset also provides information on the economic and social context (including national and local conditions)

28 See Appendix section on The PSED Model and Research Design.

29 See Appendix for detailed information about the process.

30 See Appendix for detail about the PSED datasets.

of the respondents. With such a large sample of individuals (64,622), the Screener is very useful for computing prevalence rates for nascent entrepreneurial activity as well as for making comparisons between nascent entrepreneurs and individuals in the comparison group on the 181 variables.

The second PSED dataset is known as the Sample. The Sample contains detailed information on the nascent entrepreneurs and individuals in the comparison group who agreed to participate in in-depth phone interviews and mail surveys. There are 1,261 respondents in the Sample (830 nascent entrepreneurs and 431 in the comparison group) and more than 1,200 variables in this dataset for most of the respondents. The Sample provides information about the nascent entrepreneurs and the comparison group on their demographic characteristics, personal context, including work and family responsibilities, social networks, personal background and work experiences, personal dispositions, decision-making styles, risk preferences, and aspirations. In addition, for the nascent entrepreneurs there is detailed information on the nature and sequence of the start-up activities pursued in the firm creation process; the sources and kinds of resources used; and the strategic focus, kinds of industries, and characteristics of the markets where the prospective firms are intended to compete. Follow-up information on the nascent entrepreneurs also was collected 12, 24, and 36 months after the first interview. The variables in the follow-ups are similar to information collected in the first interviews, except that where firms have been started, information on the characteristics of the new firms also was collected.[31]

Sample Selection for this Study

The researchers in this study followed procedures consistent with Reynolds for selecting cases from the PSED sample for inclusion in the analyses.[32] First, they selected cases that did not report going into business prior to the initial interview, then cases in which (1) at least one follow-up interview was conducted, (2) the entrepreneur had engaged in three or more start-up behaviors, (3) two start-up activities occurred within a 12-month period, and (4) the entrepreneur did not report positive monthly cash flow two years prior

31 Additional information about the methods and sampling used to generate the PSED can be found in Gartner, Shaver, Carter, and Reynolds (2004) *Handbook of Entrepreneurial Dynamics*. The Institute for Social Research at the University of Michigan administers the PSED (http://projects.isr.umich.edu/psed/), and a comprehensive overview of all datasets, questionnaires, and codebooks can be found at: www.psed.info/.

32 Reynolds, 2007.

to any other start-up event. Finally they selected cases in which the first start-up activity was reported less than five years before the initial interview. These decision rules resulted in the selection of 638 cases.

Given the concern about survivor bias, a number of arguments have been offered that strongly urge researchers interested in the activities of nascent entrepreneurs to use cohorts of individuals initiating firms within the same time frame.[33] For example, Gartner, Carter, Lichtenstein and Dooley suggested that a cohort of nascent entrepreneurs who first began start-up activities within two years of the initial interview date would be appropriate, while Delmar and Shane suggest a cohort of nascent entrepreneurs within one year of the initial interview.[34] Reynolds has strongly disagreed with this assessment and provides alternative evidence indicating that selecting a cohort of nascent entrepreneurs who first began start-up activities within five years of the initial interview would be appropriate.[35] The researchers conducted their own set of analyses of different cohort groups of nascent entrepreneurs who originally initiated start-up actions within 24, 36, 48, 60, and 72 months before the date of the initial interview. Based on these analyses, they selected a cohort group with entrepreneurs who initiated start-up actions within 48 months of the initial interview date. This cohort group represented the best tradeoff for maximizing the number of cases with complete responses to the questions while minimizing any significant differences in the overall characteristics of the cohort sample. This approach led to a cohort of 312 nascent entrepreneurs used in this study.

The PSED dataset comes with post-stratification weights for each respondent based on estimates from the U.S. Census Bureau's Current Population Survey.[36] The post-stratification scheme was based on gender, age, racial and ethnic background, and educational attainment.[37] Applying these weights for analyses is essential for the generalizability of any studies related to the

33 Delmar and Shane, 2003, 2004; Gartner and Carter, 2003.

34 Delmar, Carter, Lichtenstein, and Dooley, 2003; Delmar and Shane, 2003, 2004.

35 Reynolds, 2007.

36 Curtin and Reynolds, 2004.

37 Household income was considered a metric in the weighting scheme. "Both household income and educational attainment provide estimates of socioeconomic status, but there are fewer missing values for educational attainment (1.8 percent versus 23.7 percent) which reduced the need to estimate weights for cases with missing values" (Curtin and Reynolds, 2004: 491).

PSED dataset. According to Curtin and Reynolds, "Weights should be used in all types of analyses."[38] In accordance with their suggestions for using these weights, the researchers adjusted the weights to reflect the reduction in the number of cases because of missing and not applicable responses.

Measures, Analyses, and Results

Dependent Variable: Start-up Status

The survey conducted at the time of the initial interview is the "Q wave" survey. Follow-up surveys were conducted at intervals of 12 (R wave), 24 (S wave), and 36 (T wave) months to evaluate the status of these start-up efforts. In each of the follow-up interviews (see Table 7.4 for question numbers), nascent entrepreneurs were asked: "How would you describe the current status of this start-up effort? Is it: (1) now an operating business, (2) still in an active start-up phase, (3) still a start-up but currently inactive, (4) no longer being worked on by anyone, or (5) something else?" The researchers combined all responses from the R, S, and T waves and assigned individual nascent entrepreneurs into three categories: (1) "in business"—the entrepreneur is operating an ongoing business; (2) "still active"—the entrepreneur is still in the process of starting the business; and (3) and (4) "inactive/quit"—the entrepreneur is no longer working on trying to start a new business or has given up. Fifty-three respondents answered (5) "something else," or did not respond. Of the remaining cases, 132 (51.1 percent) were "inactive/quit"; 22 (8.3 percent) were "still active"; and 105 (40.6 percent) were "in business."

Independent Variables

Business Planning

In each of the four waves of data collection (Q, R, S, and T), nascent entrepreneurs were asked the question, "Has a business plan been prepared for this start-up?" The following scenarios were coded 1 for "Business plan has been prepared": nascent entrepreneurs had prepared a business plan either in Q

38 Curtin and Reynolds, 2004: 492.

wave, or at a later wave, such as R, S, or T. Cases were coded 0 for "Business plan has not been prepared."[39]

Business Plan Formalization

The responses from Q, R, S, and T to the question: "What is the current form of your business plan?" were coded 1 for "unwritten/in head," 2 for "informally written" and 3 for "formally prepared." For cases where inconsistent responses occurred among four waves of responses from Q, R, S, and T, the following decision rule applied. If the response at a later round showed an increased degree of formalization (i.e., from unwritten/in head to informally written, or to formally prepared), the highest level of formalization in business planning was coded at the later round. For nascent entrepreneurs who claimed a higher level of formalization in business planning (written business plan) at an early round of data collection (e.g., Q round), but changed to a low level of formalization (informally written) at a later round (e.g., S round), they were coded at the highest level of formalization. This situation may have occurred because the nascent entrepreneurs changed or modified their ideas and their business plans as well. Regardless of the reasons, the change of response at a later round should not change the fact that the nascent entrepreneurs engaged in a formal business planning process at the early stage.[40]

Business Plan Timing

Business planning may occur at any point along a sequence of start-up activities. Entrepreneurs were interviewed about whether they had completed (yes or no) any of 26 different start-up activities (Tables 7.2 and 7.3). If an entrepreneur said "yes," a month and year were also provided for when that activity occurred. The determination of whether business planning was early or late in the sequence of start-up activities along the four rounds of data collection—Q, R, S, and T—was based on the time (in months) from the date any one of the 26 start-up activities was initiated to the date when business planning occurred. This number was divided by the total gestation time, which is determined as the time (in months) between the dates of the earliest

39 In eight cases, nascent entrepreneurs provided inconsistent claims, in that a business plan was first prepared in Q round, but the response was changed to "a business plan has not been prepared." The RESIDs for these eight cases are 328100097, 328100113, 328100222, 328100268, 328100430, 328100519, 328100619, and 337800153. These cases were excluded from the analysis.

40 Fourteen cases in which nascent entrepreneurs claimed to have both unwritten and informally written business plans, and eight cases in which they claimed "something else" were eliminated.

Table 7.2 Source of Business Start-up Activities in the PSED

Reynolds and Miller, 1992	Gatewood, Shaver, and Gartner, 1995	Carter, Gartner, and Reynolds, 1996	PSED
Activities			
Personal Commitment		Devoted 35+ hours/week on business	Devoted 35+ hours/week on business
			Arranged child care
Financial Support	Saved money to invest	Saved money to invest	Saved money to invest
	Asked for funding	Asked for funding	Asked for funding
	Established credit with suppliers	Got financial support	Established credit with suppliers
		Invested own money	Invested own money
Hiring	Hired employees or managers	Hired employees	Hired employees/ managers
	Organized team	Organized team	Organized team
	Prepared business plan	Prepared business plan	Prepared business plan
	Developed prototype	Developed prototype	Developed model or procedures of product/service
	Applied for copyright, patent, trademark	Applied for license, patent, or permits	Applied for copyright, patent, trademark
	Purchased, rented or leased major equipment	Purchasds facilities, equipment, or property	Purchased, rented or leased major equipment
	Defined market opportunity	Rented or leased facilities/ equipment/property	Defined market opportunity
	Developed financials		Developed financials
	Started marketing , promotion		Started marketing, promotion

	Purchased raw materials, supplies		Purchased raw materials, supplies
	Took a classes or workshop on starting business		Took a class on starting a business
		Formed legal entity	
			Opened business bank account
Indicators			
Sales	Received money, income, or fees	Received money, income, or fees	Received money, income or fees
		Positive cash flow	Positive cash flow
			Paid managers who are owners a salary
		Filed federal taxes	Filed federal taxes
		Paid FICA	Paid FICA
		Unemployment insurance	Unemployment insurance
		D&B listing	D&B listing
			Business phone listing Business phone line

Source: Lichtenstein, Carter, Dooley, and Gartner, 2007: 242. Used with permission.

Table 7.3 Business Start-up Activity Questions in the PSED

The wording of questions is taken from the initial interview.

Q109	First, did you spend a lot of time thinking about starting the new business, or did the idea suddenly occur? (1 = spent a lot of time thinking; 2 = idea suddenly occurred; 3 = both, 0 = other) [1]
Q110	And in what year? (did you start to think about this new business)? (four-digit year; 9999 = Don't know or Not applicable) [2]
Q110a	And in what month (actual month 1 = 12; 13 = winter; 14 = spring; 15 = summer; 16 = fall; 99 = DK; NA)
Q111	A business plan usually outlines the markets to be served, the products or services to be provided, the resources required, including money, and the expected growth and profit for the new business. Has a business plan been prepared for this start-up? (1 = yes; 2 = no)
Q112	Has it (preparing a business plan) not yet been done or is it not relevant to this business? (1 = Not yet done; 2 = not relevant to this business)
Q113	Is the business plan in process or completed? (1 = in process; 2 = completed)
Q114	What is the current form of your business plan – unwritten or in your head, informally written, formally prepared, or something else? (1 = unwritten/in head; 2 = informally written; 3 = formally prepared; 4 = both 1 and 2; 0 = something else)
Q116	Has a start-up team been organized? (A start-up team is more than one person that helps to put the firm in place, expecting to share ownership. If both married partners own and operate a business, that is a start-up team) (1 = yes; 2 = no)
Q117	Will a start-up team be organized, or is it not relevant to this business? (1 = team will be organized; 2 = not relevant to this business)
Q118	Is organizing a start-up team in process or completed? (1 = in process; 2 = completed)
Q120	At what stage of development is the product or service this start-up will be selling (1 = completed and ready for sale or delivery; 2 = prototype/procedure tested with customers; 3 = model/procedure is being developed; 4 = still in idea stage; 0 = no work has been done on a product or service).
Q122	Have marketing or promotional efforts been started for the product or service this start-up will be selling (1 = yes; 2 = no)
Q124	Has an application for patent, copyright, or trademark relevant to this new business been submitted? (1 = yes; 2 = no)
Q125	Will a patent, copyright, or trademark application related to this business be submitted, or is it not relevant? (1 = will be submitted; 2 = not relevant)
Q126	Has the patent, copyright, or trademark been granted or is it in the process? (1 = granted; 2 = in process)
Q128	Have any raw materials, inventory, supplies, or components for the new start-up been purchased? (1 = yes; 2 = no)
Q129	Will any raw materials, inventory, supplies, or components be purchased or is this not relevant? (1 = intend to purchase; 2 = not relevant)
Q131	Have any major items like equipment, facilities, or property been purchased, leased, or rented for the new start-up? (Major is defined as any item with a retail or sale value of more than $1,000, and this could be physical space or internet space, like a website). (1 = yes; 2 = no)
Q132	Will there be a purchase, lease, or rent of any major items like equipment, facilities, or property, or is this not relevant? (1 = will be a purchase, lease, or rent, 2 = not relevant)
Q134	Has an effort been made to define the market opportunity by talking with potential customers or getting information about the competition? (1 = yes; 2 = no)
Q135	Will an effort be made to define the market opportunities, or is this not relevant? (1 = effort will be made; 2 = not relevant)

Q137	Have projected financial statements, such as income and cash flow statements or break-even analysis, been developed? (1 = yes; 2 = no)
Q139	Are you now saving money to invest in this business? (1 = yes; 2 = no)
Q140	Have you finished saving money to invest in the new firm, or is that still in process? (1 = finished saving money; 2 = still in process)
Q141	Do you intend to start saving money to invest in the firm, have you finished saving money to invest, or do you consider it not relevant in this case? (1 = intend to start saving;, 2 = finished saving; 3 = not relevant in this case)
Q143	Have you invested any of your own money in this business? (1 = yes; 2 = no)
Q145	Have financial institutions or other people been asked for funds? (1 = yes; 2 = no)
Q146	Is asking others or institution for funds completed or still in process? (1 = completed; 2 = in process)
Q147	Will others or financial institutions be asked for funds, or is this not relevant for this start-up? (1 = others will be asked; 2 = not relevant)
Q149	Has credit with a supplier been established? (1 = yes; 2 = no; 3 = not relevant)
Q150	Have you arranged childcare or household help to allow yourself time to work on the business, either formally or informally with friends and relatives? (1 = yes; 2 = no)
Q153	Have you begun to devote full time to the business, that is, 35 or more hours per week? (1 = yes; 2 = no)
Q155	Have any employees or managers been hired for pay – workers that would NOT share ownership? (1 = yes; 2 = no)
Q156	Will any employees or managers be hired for pay, or are they not relevant for this business (1 = will be hired; 2 = not relevant)
Q160	Has a bank account been opened exclusively for this new business? (1 = yes; 2 = no; 3 = using an existing commercial account)
Q162	Has the new business received any money, income, or fees from the sale of goods or services? (1 = yes; 2 = no)
Q163	Does the monthly revenue now exceed the monthly expenses? (1 = yes; 2 = no)
Q165	Are salaries for the managers who are also owners included in the computation of monthly expenses? (1 = yes; 2 = no)
Q167	Have you taken any classes or workshops on starting a business? (1 = yes; 2 = no)
Q171	Does the new business have its own listing in the phone book? (Enter "yes" if no phone listing because it is only an internet business). (1 = yes; 2 = no; 3 = sharing existing business listing)
Q175	Has the new business paid any state unemployment insurance taxes? (1 = yes; 2 = no)
Q177	Has the new business paid any federal social security taxes, sometimes called FICA payments? (1 = yes; 2 = no)
Q179	Has the new business filed a federal income tax return? (1 = yes; 2 = no)
Q181	To your knowledge, is the new business listed with Dun and Bradstreet, the credit rating firm? (1 = yes; 2 = no)

[1]For all questions that are not date- and time-related: 8 = don't know; 9 = not applicable.
[2]Every behavior question has a year and month question as to when the activity was completed or undertaken.

Source: Gartner, Carter, and Reynolds (2004: 291-292). Used with permission.

and latest activities indicated from responses in Q, R, S, and T waves. For those events where a year and season were reported (winter, spring, summer, or fall) rather than a month, an appropriate month (February, May, August, or November) was assumed. For those in which only a year was provided, the month was assumed to be June.

Number of Start-up Activities

Following the approach employed by Reynolds and Miller, the researchers counted the number of activities/events engaged in by entrepreneurs during the start-up process through Q, R, S, and T waves of data collection.[41] In a few cases, nascent entrepreneurs reported the same activity in a follow-up interview wave. In those cases, meticulous efforts were taken to ensure that the initiation of one start-up activity was counted once, not repeatedly, and that the activity was identified the first time it was listed.

Other Independent Variables/Covariates

Prior studies argue that the persistence or survival of new ventures depends upon the founder's human capital.[42] Following Shane and Delmar, the researchers controlled for five dimensions of human capital: education, industry experience, managerial experience, prior start-up experience, and the start-up team.[43] For education (Q343), nascent entrepreneurs were asked "what is the highest level of education you have completed so far?" Responses were coded on an ordinal scale from 0 to 9, with 0 indicating "up to eighth grade," and 9 indicating "JD, DBA, or Ph.D." Studies suggest that entrepreneurs with more industry experience are less likely to terminate their new ventures.[44]

Industry experience was measured as the total years of full-time paid work experience in any field within the industry in which these nascent entrepreneurs were starting their emerging firms. For managerial experience, nascent entrepreneurs were asked to respond to the question "For how many years, if any, did you have any managerial, supervisory, or administrative responsibilities?" Consistent with Bruderl and Preisendorfer (1998), the researchers controlled for prior start-up experience and whether the entrepreneur was

41 Reynolds and Miller, 1992.

42 Bates, 1990; Bruderl, Preisendorfer, and Ziegler, 1992; Castrogiovanni, 1996.

43 Shane and Delmar, 2004.

44 Bates, 1990.

involved with a start-up team. Prior start-up experience was measured by the number of start-ups in which a nascent entrepreneur had been involved. First-time entrepreneurs were coded 0 and those with prior start-up experience were coded 1. Lechler, in a review of research on ventures formed by teams versus solo founders indicated that teams were more successful.[45] A dummy variable was created, with 0 for solo start-up and 1 for a start-up team. The researchers also controlled for the industry: tech-based (1) and non-tech-based (0).

To test the effect of assistance programs on venture creation, the researchers created two dummy independent variables—taking classes on starting a business (Q167) and contact with government-sponsored programs (Q303), with 0 for "no" and 1 for "yes." Table 7.4 provides a summary of all the dependent and independent variables in the analysis.

Analyses

A multinominal logistic regression model[46] was conducted to identify the combination of independent variables that differentiate nascent entrepreneurs in the "in business" and "still active" types relative to nascent entrepreneurs in the "inactive/quit" reference type, which is the baseline model. The baseline logit simply compares each category to a baseline category where all the coefficients for the variables are "0."[47]

As there are three categories in the start-up status variable, there will be two sets of logit functions, where each will be compared with the baseline category of "inactive/quit."

Analysis of variance (ANOVA) with Bonferroni post hoc comparisons are used to further highlight the differences in business planning, formalization of business planning, and timing of business planning across "in business," "still active," and "inactive/quit" groups. ANOVA models are also used to compare the mean differences in the number of start-up activities across business planning and business plan formalization variables.

Results

Table 7.5 lists means, standard deviations, and correlations for the dependent and independent variables. Table 7.6 shows the results of multinominal

45 Lechler, 2001.

46 Maddala, 1983.

47 SPSS, 1999.

Table 7.4 Variable Definitions and Measures

Variable definition	PSED	Item description and coding
Dependent variable		
Start-up status	R502	2 = in business?
	S502	1 = still active?
	T502	0 = discontinued?
Independent variables		
Education	Q343	Educational achievement: (0 = up to eighth grade; 1 = some high school; 2 = high school; 3 = tech or vocational degree; 4 = some college; 5 = community college; 6 = college; 7 = some graduate training; 8 = MS, MBA, MA; 9 = LLB, Ph.D, degree
Gender	ncgender	1 = male, 0 = female
Industry	Q301	1 = tech; 2 = non-tech
Management experience	Q341	Years of managerial, supervisory and administrative experience.
Industrial experience	Q340	Years of paid full-time experience
Start-up experience	Q200	Number of businesses helped to start; 0 = no, 1 = yes
Start-up team	Q116 R573 S573 T573	Has a start-up team been organized? 0 = no, 1 = yes
Business planning		
Completed a business plan? Y/N	Q111+ R568+ S568+ T568	Have a business plan been prepared for? 1 = yes; 0 = no. (Reviewed four responses from Q, R, S, T)
Business plan relevance	Q112+ R569+ S569+ T569	Has it (preparing a business plan) not yet been done, or is it not relevant to this business? (1 = not yet done; 2 = not relevant to this business)
Business plan status	Q113+ R570+ S570+ T570	Is the business plan in process or completed? (1 = in process; 2 = completed)
Formalization of business planning	Q114 R571 S571 T571	What is the current form of your business plan – unwritten or in your head, informally written, or formally written?
Timing of business planning		Defining the timing of business planning along with the duration of venture gestation.
Government assistance program		
Taking classes(Y/N)	Q167+ R625+ S625+ T625	Have you taken any classes or workshops on starting a business? (0 = no; 1 = yes)
Programs contacted (Y/N)	Q303+ R755+ S755+ T755	Many programs to help new business get established have been developed. Federal, state, and local governments, universities, and voluntary associations sponsor them. Have you made contact with such program? (0 = no; 1 = yes)

Table 7.5: Descriptive Statistics and Correlations

	N	Mean	Std	1	2	3	4	5	6	7	8	9	10	11	12
1. Years of Education	311	4.574	2.031	1.000											
2. Gender	312	0.477	0.500	-0.063	1.000										
3. Years of industry experience	312	17.079	10.821	0.096*	0.099*	1.000									
4. Years of managerial experience	309	8.256	8.304	.216***	0.078	.679***	1.000								
5. Prior start-up experience	141	0.518	0.501	0.059	-0.043	.178**	.307***	1.000							
6. Industry (tech vs nontech)	300	0.320	0.467	0.021	0.111*	-0.052	-0.003	0.035	1.000						
7. Contacts with government-sponsored programs	310	0.118	0.323	.175***	0.026	-0.001	-0.071	0.047	0.027	1.000					
8. Taking classes or workshops	311	0.342	0.475	.136**	-0.072	-0.023	-0.004	0.010	0.058	.175***	1.000				
9. Start-up team organized? Yes/No	311	0.586	0.493	-0.021	0.050	0.035	0.098*	0.043	0.007	0.027	-0.033	1.000			
10. Has a business plan been prepared for?	307	0.675	0.469	0.073	-0.078	0.004	0.066	0.068	.142**	0.008	0.100*	.230***	1.000		
11. The degree of business plan formalization	209	2.288	0.701	0.125*	0.006	-0.003	0.022	0.142	0.126*	0.050	0.033	-0.086	0.039	1.000	
12. Timing of business planning	211	0.471	0.326	-0.045	-0.057	-0.071	-0.142**	0.070	0.067	0.036	0.036	0.010	-0.079	-0.139**	1.000

*** a <=0.01; ** a <=0.05; *a<=0.1.

Table 7.6 Multinominal Logistic Regression Models

	Model 1							
	Still active			In business			Still active	
	ß	Wald	Exp(ß)	ß	Wald	Exp(ß)	ß	Wald
Constant	-2.261	3.151*					-12.358	5.802**
Education	-0.093	0.227	0.911	-0.214	2.269	0.807	0.409	0.773
Gender	0.424	0.332	1.528	1.205	5.689**	3.336	0.361	0.056
Industrial experience	0.051	1.434	1.052	0.007	0.041	1.007	0.249	4.886**
Managerial experience	-0.012	0.059	0.988	0.002	0.002	1.002	-0.172	2.842*
Prior startup experience	0.414	0.344	1.513	0.085	0.029	1.088	3.668	4.023**
Startup team	0.755	1.146	2.127	-0.365	0.499	0.694	-0.801	0.265
Industry	-0.516	0.415	0.597	-1.065	3.493*	0.345	0.010	0.000
Government-sponsored programs	-0.270	0.057	0.763	1.176	3.029*	3.241	-22.229	0.000
Taking classes or workshops	-1.179	1.914	0.308	-0.088	0.030	0.916	-0.992	0.563
Business planning	-0.066	0.008	0.937	1.788	8.522**	5.979		
Business plan formulation							1.341	1.975
Timing of business planning								
Δ-2 log likelihood chi-square			29.169*					
Goodness-of-fit (deviance chi-square)			176.031 (p=.888)					
Cox/Snell pseudo R2			0.228					
Nagelkerke pseudo R2			0.272					
Overall percent correctly classified			66.70%					

The reference category is Inactive/Quit.
* a<=0.10.
** a<=0.05.
*** a<=0.01.

logistic regression models rotating the variables of business plan, business plan formalization, and timing of business plan. The validity of the analysis was assessed by means of three major parameters, namely, model fitting information, goodness-of-fit information, and R^2.

In the model fitting information, the −2 log likelihood value is the intercept-only of the model, and the chi-square value is the difference between the intercept-only and the final model. As shown in Table 7.6, the observed chi-squares for models I, II, and III were 29.169 ($p<0.1$), 25.120 ($p<0.05$),

Model II				Model III					
	In business			Still active			In business		
Exp(ß)	ß	Wald	Exp(ß)	ß	Wald	Exp(ß)	ß	Wald	Exp(ß)
	-0.768	0.229		-14,665	4.338**		1.408	1.220	
1.505	-0.281	2.603	0.755	0.917	2.006	2.501	-0.344	3.432*	0.709
1.435	1.421	5.474**	4.142	0.814	0.206	2.256	1.517	5.887**	4.560
1.283	0.005	0.017	1.005	0.504	5.397**	1.656	-0.003	0.004	0.997
0.842	-0.024	0.190	0.977	-0.545	4.812**	0.580	-0.024	0.196	0.976
39.188	-0.123	0.039	0.884	9.996	5.274**	21.929	0.030	0.002	1.030
0.449	-0.336	0.292	0.715	-0.462	0.054	0.630	-0.479	0.584	0.620
1.010	-0.603	0.755	0.547	1.533	0.782	4.631	-0.664	0.869	0.515
1.000	1.600	2.914*	4.955	-26.547	0.000	1.000	1.856	3.780*	6.400
0.371	0.155	0.065	1.168	-2.082	1.278	0.125	0.028	0.002	1.028
3.823	1.610	2.280**	5.003						
				-13.773	4.125**	0.000	-0.654	0.539	0.520
25.120**						43.570***			
96.080 (p =.947)						86.919 (p =.986)			
0.389						0.460			
0.462						0.546			
69.00%						76.20%			

and 43.570 (p<0.01) respectively. It can be concluded that the final models are significantly better than the intercept-only models in all three models.

The goodness-of-fit test measures the fitness of the data collected to the model that is being proposed. Deviance chi-square was used to assess goodness of fit. Deviance chi-square is the change in −2 log-likelihood when the model is compared to a saturated model, that is, when it is compared to a model that has all main effects and interaction. If the model fits well, the log-likelihood should be small and the observed significance level should be large.

As shown in Table 7.6, the deviance chi-squares for models I, II, and III are 176.031 (p=.888), 96.080 (p=.947), and 86.919 (p=.986), suggesting a good fit for all three models.

The pseudo R^2 statistic represents the proportion of variability in the dependent variable that can be explained by the independent variables. Correlation between the variables increases with higher values of the R^2 statistic. As shown in Table 7.6, the Cox/Snell pseudo R^2 statistics for models I, II, and III were .228, .389, and .460, respectively. The Nagelkerke pseudo R^2 statistics were .272, .462, and .546 for models I, II, and III, respectively, thereby demonstrating good explanatory power of the models.

The analysis also provides a classification table that compares the observed and predicted groups with their prediction probabilities. The classification table shows how well a model fits its data. In all three models as shown in Table 7.6, the overall percentages of correct classification were 66.7 percent, 69 percent, and 76.2 percent, suggesting a good successful rate for all models. The percentage is determined by the classification table generated by the logistic model where the logistic equation is applied to the original dataset and the predicted value (0 versus 1) is compared to actual value (0 versus 1). If the predicted value is the same as the actual value (e.g., 0 and 0, 1 and 1), the classification is correct. Otherwise, the classification is false. Therefore, the larger the percentage of correct classifications, the better is the fitness of the model.

Business Planning, Formality, and Timing

Evidence in Table 7.4 suggests that the "in business" entrepreneurs were associated with business planning with a coefficient of 1.788 ($p<0.01$), which is a significant discriminating factor with regard to "still active" and "inactive/quit" entrepreneurs. This finding suggests that the "in business" entrepreneurs are more active in developing business plans. The table also shows that engaging in business planning increases the probability of successfully starting a new business by a factor of 6 ($Exp(\beta)=5.979$).

The coefficients for the formalization of business plan under model II are statistically significant for the "in business" entrepreneurs. This finding suggests that the greater the degree of business plan formalization (e.g., going from a plan in one's head to a formal written plan), the more likely it is that an entrepreneur will successfully start a new business.

The "still active" nascent entrepreneurs have a coefficient of -13.773 ($p<0.01$) for the timing of business planning, but this coefficient is not significant for the "in business" type (β =-0.654). This result suggests that the "still active" entrepreneurs are likely to complete a business plan earlier than their "in business" and "inactive/quit" counterparts, but that most of the difference is between the "still active" entrepreneurs and the "inactive/quit" entrepreneurs.

The coefficients for government-sponsored programs (Table 7.4) are 1.176 ($p<0.1$), 1.600 ($p<0.1$), and 1.856 ($p<0.1$), respectively. This finding suggests that contact and participation in government-sponsored programs significantly differentiates between the "in business" entrepreneurs and the "inactive/quit" entrepreneurs. The exp(ß) has values of 3.241, 4.955, and 6.4, respectively, suggesting that, on average, entrepreneurs who contact and participate in government programs are about five times more likely to successfully start a new business.

The coefficients for industry experience, managerial experience, and prior start-up experience (Table 7.6) are all statistically significant and significant discriminators between the "still active" and "inactive/quit" entrepreneurs. While the signs for industry experience and prior start-up experience are positive, the sign is negative for managerial experience. These findings suggest that entrepreneurs with less industry experience and "no or limited prior" start-up experience were more likely to be inactive or to quit during the venture creation process. However, less managerial experience tended to be associated with the "still trying" group. The "in business" entrepreneurs seem to have less industry, managerial, and prior start-up experience.

Finally, gender has a positive and significant coefficient for all three models for the "in business" entrepreneurs (β =1.205, $p<0.05$; β = 1.421, $p<0.05$; β = 1.571, $p<0.05$), suggesting that male nascent entrepreneurs have a higher likelihood of starting a business while female entrepreneurs have a higher probability of being in the "inactive/quit" group (Table 7.6).

Other variables such as taking classes and workshops on starting a business, having a start-up team, industry, and education, were included in the model, but none of these variables were found be statistically significant discriminators across all three of the multinominal logistic regression models.

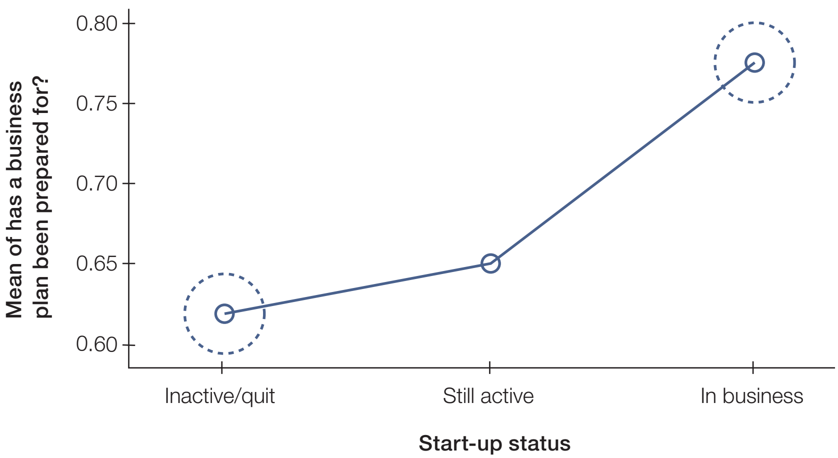
Analysis of Variance (ANOVA)

As indicated in Table 7.7, using the statistical technique of analysis of variance, the mean differences for business plan, business plan formalization, and

Table 7.7 Analysis of Variance (ANOVA)

Variables	Groups	Means		Sum of squares	df	Mean square	F
Has a business plan been prepared for?	Inactive/quit	0.614	Between groups	1.332	2	0.666	3.080**
	Still active	0.658	Within groups	54.285	251	0.216	
	In business	0.766	Total	55.618	253		
The degree of business plan formalization	Inactive/quit	2.176	Between groups	3.719	2	1.859	3.853**
	Still active	2.243	Within groups	83.001	172	0.483	
	In business	2.476	Total	86.720	174		
Timing of business planning/ gestation duration	Inactive/Quit	0.565	Between groups	1.876	2	0.938	10.344***
	Still active	0.316	Within groups	15.601	172	0.091	
	In business	0.378	Total	17.477	174		

Figure 7.3 Mean Plot of Business Planning (Yes = 1, No = 2) and Start-up Status



timing of business planning were statistically significant across "in business," "still active," and "inactive/quit" groups.

Figures 7.3, 7.4, and 7.5 provide the mean plots for all three planning variables. Bonferroni post hoc comparisons suggest that "in business" nascent entrepreneurs did significantly more business planning (mean =.766) than their "inactive/quit" counterparts (mean = .614). Similarly, the degree of

Figure 7.4 Mean Plot of Degree of Business Plan Formalization and Start-up Status

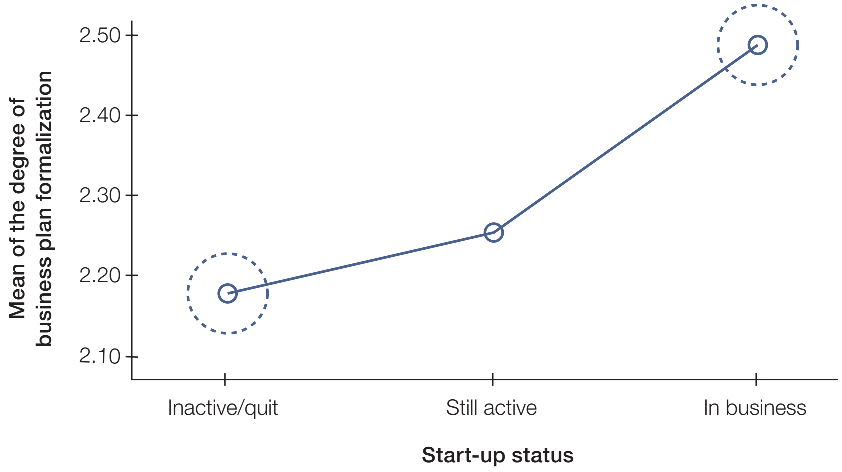
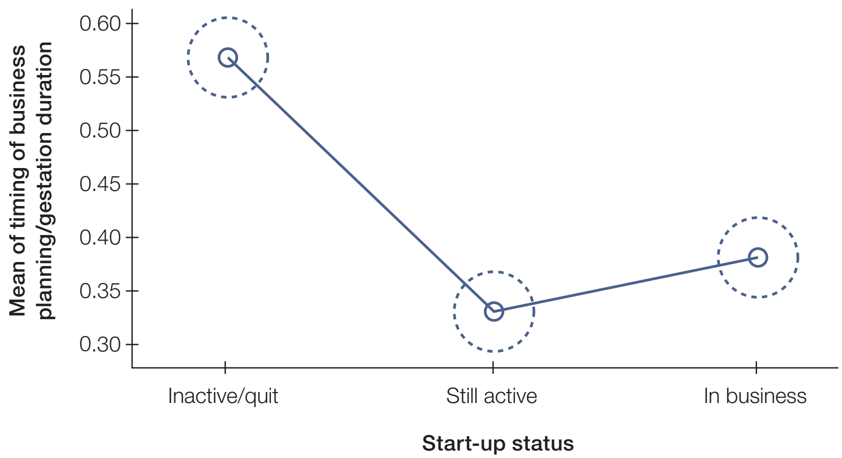


Figure 7.5 Mean Plot of Timing of Business Planning and Start-up Status



business plan formalization is significantly greater for the "in business" group (mean = 2.476), compared with the "inactive/quit" group (mean = 2.176). In terms of the timing of business planning (early or late), the "still active" group seems to engage in business planning significantly earlier (mean = 0.316) than the "in business" group (mean = 0.378), followed by the "inactive/quit" group (mean = 0.565). This finding may suggest that once "inac-

Figure 7.6 Mean Plot of Degree of Business Planning and Start-up Activities

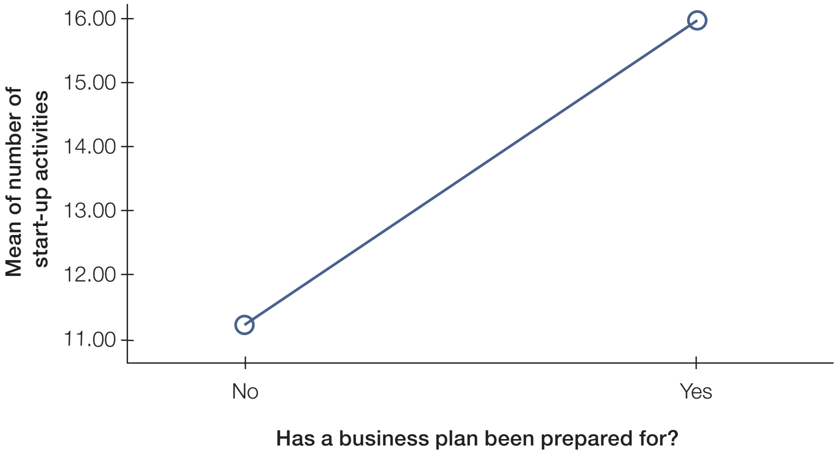
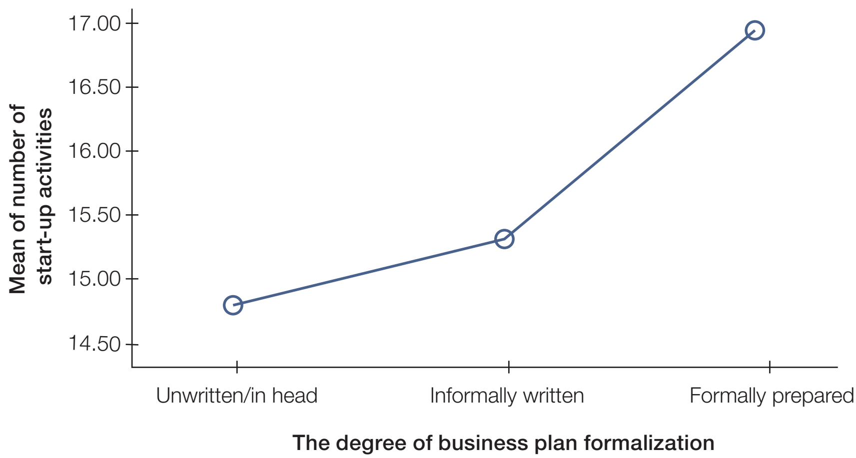


Figure 7.7 Mean Plot of Degree of Business Plan Formalization and Start-up Activities



tive/quit" entrepreneurs engage in business planning, their planning efforts show that continuing to pursue starting a new venture is unfeasible and should be abandoned. By contrast, "still active" nascent entrepreneurs seem to jump into business planning early, but their plans do not lead to additional start-up activities that might lead to successfully starting a business.

As indicated in Figure 7.6, the number of start-up activities for nascent entrepreneurs "with a business plan" and "without a business plan" averaged

15.793 and 11.306 respectively, and is statistically significant ($p<0.01$). This finding suggests that nascent entrepreneurs who completed a business plan tended to engage in more start-up activities than those without a business plan. Of those nascent entrepreneurs who had business plans, the average number of start-up activities for different levels of business plan formalization, namely "unwritten," "informally written," and "formally prepared" are 14.787, 15.195, and 16.898, respectively (Figure 7.7). The ANOVA and its subsequent post hoc pairwise comparisons are all statistically significant ($p<0.01$). The results suggest that the number of start-up activities entrepreneurs engage in increases significantly with an increased level of business plan formalization.

Discussion

The researchers believe that the results from the analyses of the PSED data on business planning provide evidence that entrepreneurs who engage in business planning will significantly increase their chances of starting a new business. The results also point to a number of other issues in the planning process that enhance the likelihood that new businesses can be successfully started. First, it will be useful to look at some of the limitations of using (1) survey data such as the PSED, (2) different cohort samples from the PSED, and (3) structured questions about planning and entrepreneurial activities, and self-reports about business success.

Limitations

As discussed earlier, it is very challenging for researchers to identify people who are in the process of starting a business, particularly if the goal of creating such a sample of entrepreneurs is to reflect the population of all individuals engaged in business start-up activity. As described in the section on the development of the PSED and in the Appendix to this chapter, determining whether someone is serious about starting a business (i.e., has actually taken some kind of action beyond thinking about wanting to start a business), and finding this person within a period of time reasonably close to when these first business start-up actions occurred, is difficult and expensive. While about 5 to 10 percent of working-age adults might be currently engaged in starting a business at any particular moment,[48] this percentage is still a somewhat relatively rare occurrence in the general population. And given that some individuals can take years in the start-up process and still not get into business, the likelihood of capturing a substantial sample of individuals in the exact moment when they actually begin their entrepreneurial efforts is very small.

The researchers believe the PSED sampling process is the most thorough and comprehensive method for finding individuals in the process of starting businesses. Given the substantial amount of funding invested in this program (more than $2.5 million), and the effort provided by a dedicated number of scholars experienced in survey methodologies and longitudinal panel studies, it is the best and most rigorous existing dataset on the business formation process.

As mentioned earlier, the selection of a contemporaneous cohort of entrepreneurs in the process of starting their businesses has a number of important tradeoffs. In the method used in the PSED, selecting individuals for inclusion in a cohort sample that are both close to the date they first thought about starting a business and that took some other action significantly reduces the number of individuals in the sample. In the analyses here of samples of entrepreneurs who first engaged in starting their firms 24, 36, 48, 60, and 72 months earlier than the time of the first interview, the sample sizes of these cohorts were 157, 254, 312, 356, and 386, respectively. Tradeoffs are made between the size of the cohort sample and the similarities in the cohort of individuals in the process of starting businesses. The researchers made best estimates of what a similar group of entrepreneurs-in-process would look like. Various cohorts chosen with different time frames can change the statistical significance of some of the findings, but the general direction of correlations and outcomes does not change.

A quantitative study such as this offers findings that are probabilistic in nature. A finding with a significance of $p < .01$ suggests 99 percent certainty that this result did not occur by chance. Since many of the analyses are comparisons of "lines" in multi-dimensional space or of mean scores (i.e., averages) between groups, the statistical inferences are always probabilities that certain factors influence others. Probabilities are not guarantees, but estimates of the likelihood something will occur. For example, this chapter

48 Reynolds, Carter, Gartner, and Greene, 2004.

suggests that planning increases the chances of getting into business, not that planning guarantees an individual will get into business.

All of the planning, activity, and outcomes measures used in this study (Tables 7.2, 7.3, and 7.4) are admittedly crude representations of what individuals actually do when they are involved in starting businesses. Entrepreneurs “self-report” whether they have completed an activity or not. The finding that an entrepreneur has completed business planning (or any other activity), then, is based on a subjective sense from each entrepreneur of what completion of business planning (or another activity) means. As the planning formalization measure describes, planning can be completed in various ways: “in your head,” or by unwritten or formal written plan. What respondents might consider a completed plan “in your head” is likely to vary. Likewise, formal business plans vary in comprehensiveness and thoroughness, and the quality differences among the various written business plans are unknown. A written business plan may be 10 pages or 100 pages, have a detailed analysis of competitors or not, provide quarterly financial proformas or not, etc. The quality of the business plan might also reflect the amount of time and effort entrepreneurs have undertaken to develop their business. The finding that individuals who write a formal business plan are likely to complete more business activities is, then, an encouraging result indicating that business plan quality is likely to be reflected in entrepreneurs doing more to understand how their business works. But the measures used do not provide many details of what entrepreneurs actually did when they completed their business plans.

The outcome measure used to indicate whether an entrepreneur had successfully started a business (or not)—Are you currently “in business, still active, or quit”?—is a self-report of these entrepreneurs’ sense of what it means to be in business, to be still active, or to have quit. Entrepreneurs may report that they are “in business,” but these businesses may not have filed for a business license, had a sales transaction, generated positive cash flow, or provided sufficient funds to employ the entrepreneur full time. Delmar and Shane (2003) used multiple measures of business success (e.g., the self-report success measure, product development, and other start-up activities) and found that business planning was positively correlated with them all, though at different levels and significance. Success at getting into business, then, should be considered like a trend toward the establishment of an actual business rather than a concrete measure such as getting a business license or filing a business tax return.

The success measure here focuses on the likelihood of getting into business rather than other measures of success that might have a longer-run impact. The success measure does not indicate whether the businesses that are started became profitable, generated positive cash flows, hired employees, grew, or survived after they started. Research that could link the kinds of emerging ventures identified in the PSED dataset with other datasets of new firms could provide valuable insights into the kinds of efforts involved in developing new firms that might lead to profitable and growing businesses.

Overall, even with very broad measures of planning, start-up activities, and outcomes, the findings about the relationship between business planning and success at starting a business appear to be fairly robust.

Results Highlights

The following summarizes the findings presented in the various parts of the results section that are likely to have the most impact on entrepreneurship policy and practice:

- Entrepreneurs who started businesses were more likely to complete a business plan than entrepreneurs who were still active or had quit the process.
- Entrepreneurs who completed a business plan were six times more likely to start a business than those in the "still active" or "quit the process" groups.
- Entrepreneurs who completed written business plans were more likely to start a business than entrepreneurs in the two other groups.
- Entrepreneurs who completed a business plan were more likely to engage in more start-up activities than entrepreneurs from the two other groups.
- Entrepreneurs who completed written business plans were more likely to engage in more start-up activities than entrepreneurs who completed less formal plans (unwritten or informally written).
- Entrepreneurs who contacted and participated in government-sponsored entrepreneurship programs were five times more likely to start a business than entrepreneurs in the two other groups.

Overall, these results suggest that entrepreneurs should engage in business planning during the start-up of their businesses and that entrepreneurs should write a formal business plan. Those entrepreneurs who planned and who wrote formal business plans were more likely to create a new business than others. Planning matters!

Suggestions for Policy

This study provides evidence of the value of government, public/private partnerships, and university efforts to provide training and assistance for entrepreneurs to develop business plans as part of the process of getting into business. Showing that the activity of business planning increases the likelihood of getting into business can be used to encourage entrepreneurs to undertake planning with the knowledge that planning is beneficial. Agencies can also use these findings to require that business plans be generated before other forms of assistance are provided (such as financing and additional consulting support and assistance). Completing a business plan is strongly correlated with completing other business start-up activities, so that a business plan is a signal that the entrepreneur is committed to ensuring that the emerging venture will come to fruition. A business plan might also be considered an indicator that an entrepreneur is committing time and effort to developing the venture. The business plan, then, might be a way to separate committed entrepreneurs from "dabblers" (those still trying) in the process.

The general tenor of this chapter implies that "success" in the business planning process occurs when businesses are started, but a successful outcome of the planning process might also be when entrepreneurs decide to quit the start-up process. Business plans that indicate that an entrepreneur's original business concept and strategy is faulty and not worthy of pursuing are also important outcomes of the business planning process. Failure can be expensive. Reducing the time and resources invested in venture ideas that are not capable of succeeding improves the efficiency of the entrepreneurial process overall. Most venture creation efforts do not result in new ventures; therefore, any activities such as planning that can reduce the resources invested in nonviable businesses are net benefits because losses are reduced.

The finding that entrepreneurs who use government programs that assist entrepreneurs are more likely to start new businesses is also an encouraging sign that current government efforts to help entrepreneurs can, indeed, help.

Suggestions for Practice

The researchers believe these results make clear the need for entrepreneurs to invest the time and resources necessary to complete a business plan. Completing a business plan and completing a written business plan strongly predict that entrepreneurs are more likely to start a new business. The finding that entrepreneurs who engage in business planning and who write more formal plans also engage in more activities suggests that business planning may not be a distraction from more important start-up activities, but a corollary to engagement in the start-up process. The results suggest that people who plan are also people who act: planners are doers!

Suggestions for Researchers

The use of longitudinal data to study the process of starting a business is invaluable for uncovering factors that influence subsequent outcomes for entrepreneurial success. The use of such crude measures of planning and other venture creation activities in the PSED, though, suggests the need for more detailed longitudinal case studies and interviews of entrepreneurs during the start-up process to ascertain their motives as well as fine-tune what specifically occurs when entrepreneurs act to create new ventures. It would also be helpful to know more about the reasons entrepreneurs engage in business planning. Few questions are asked in the PSED that attempt to explore why nascent entrepreneurs engage in the activities they do. Providing reasons for planning activities would generate many insights into whether business plans were used to raise capital, etc. Supplementing the PSED cases with matching in-depth case studies of nascent entrepreneurs (i.e., finding nascent entrepreneurs who have similar demographic, start-up, and venture characteristics) could help identify more of the details and logic used by these individuals for how and why they planned.

It would be valuable to explore which specific activities in the business planning process might be more beneficial to entrepreneurs during the start-up process. For example, specific activities involved with finding customers and discerning their needs might be more helpful than other activities, such as developing pro-forma financial statements. Different, specific planning activities might be more or less valuable depending on the types of businesses entrepreneurs are starting or the industries in which these businesses might be competing.

One issue for researchers involved in studying the process of new venture creation to consider is whether entrepreneurs understand the business model for their prospective ventures; that is, do most entrepreneurs understand the specific "formula" for how they will make money? Many entrepreneurs may successfully start a new business, but lack critical insights into how to grow and develop their fledgling firms into businesses that can be profitable and provide positive cash flow. Research that can better define and operationalize the characteristics and processes involved in developing profitable business models would provide significant insights into the value of business planning for venture success.

Conclusions

The finding that entrepreneurs who complete a business plan are six times more likely to get into business than those who do not is a result of some consequence. Nearly all of the evidence offered in this chapter suggests that completing a business plan, and, better, writing a business plan, is positively correlated to getting into business. So completing a business plan is an activity that should be encouraged for entrepreneurs involved in the business start-up process. In a more conservative vein, there appears to be no evidence that business planning, completing a business plan, or writing a business plan is detrimental to the successful development of a business. Planning does not seem to detract from other entrepreneurial activities necessary for starting a business. Indeed, business planning seems to be a strong signal that an entrepreneur is undertaking other important tasks to ensure success at new venture creation. The bottom line is: if you are actively starting a business, do a business plan.

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Appendix

The PSED Model and Research Design

National screening of the adult population was completed by a commercial market research firm (TeleNation Program, Market Facts, Inc.; Arlington Heights, IL). The screening process identifies three random samples of 1,000 adults each week in the contiguous 48 states. Random digit dial sampling procedures (the actual phone numbers are randomly generated) are used to locate households, listed and unlisted. The first individual 18 and older that will complete the phone interview is accepted as a respondent. Quota sampling is used to ensure that half of each sample are men and the other half women. Each sample is completed in a three-day period with a three-call criterion (initial call and two call-backs). However, up to 2 percent of the respondents are called 4-9 times to complete an interview. The interviews are controlled to be less than 30 minutes long to minimize mid-interview terminations.

Five such subsamples were generated from the telephone screening. The first subsample (labeled below as ERC) has been identified as the "ERC sample" or the "mixed gender" sample in other studies. The "ERC" sample was funded by the Entrepreneurship Research Consortium, a group of universities and foundations. The second subsample (labeled CG-ERC) was the "mixed gender" comparison group, also funded by the ERC. The third subsample (labeled NSF-W) has been called the "NSF women only" subsample, as it was funded by a grant to Nancy Carter from the National Science Foundation (NSF) to study women nascent entrepreneurs. The fourth subsample (labeled NSF-MIN) is known as the "NSF minority oversample," as it was funded through a grant to Patricia Greene from the NSF to study minority nascent entrepreneurs. Finally, a fifth subsample (labeled CG-MIN) was collected that focused on a "minority oversample comparison group," that was also funded by the NSF grant to Greene.

Because the two different NSF grants came several months apart, the national screening process for identifying nascent entrepreneurs occurred over two broad time periods. Screening of individuals targeted for the nascent entrepreneur ERC group began in July 1998 and ended in April of 1999. Screening of individuals targeted for the NSF-W oversample began in September 1998 and ended in December 1998. Together, these two samples

Table 7A.1 Reported Involvement in Start-up Activity

Target of sample	Pool size	Reports autonomous start-up during market facts screening (SUINVOL)			
		NIE [a]	NCE [b]	Both [c]	Total
ERC					
F	7,563	355	157	59	571
M	7,555	586	260	136	982
NSF-W					
F	8,099	367	147	52	566
M	8,044	577	288	127	992
NSF-Min					
F	14,632	657	280	128	1,065
M	13,682	985	393	211	1,589
CG-ERC					
F	1,007	Unknown. Not asked.			
M	1,003	Unknown. Not asked.			
CG-Min					
F	1,574	80	30	7	117
M	1,463	109	35	29	173
Totals:	64,622	3,527[d]	1,525 [d]	713 [d]	5,765 [d]

a NIE = Nascent Entrepreneur. A "yes" response to: Are you, alone or with others, now trying to start a new business?
b NCI = Nascent Corporate Entrepreneur. A "yes" response to: Are you, alone or with others, now starting a new business or new venture for your employer? An effort that is part of your job assignment?
c Both. Answered "yes" to both of the NIE + NCE questions.
d Totals for all classifications of nascent entrepreneurs do not include the respondents from either comparison group.

of potential nascent entrepreneurs comprised a total of 31,261 individual respondents. Screening for the CG-ERC comparison group began and was completed in November 1998 with a total of 2,010. Screening for the NSF-MIN minority oversample began in July 1999 and ended in January 2000 with a case listing of 28,314 people. Finally, screening of the CG-MIN minority oversample comparison group began and ended in November 1999 with a case listing of 3,037 people. Thus, a total of 64,622 individuals were screened between July 1998 and January 2000. The characteristics of the various subsamples in the Screener are listed in Table 7A.1.

Whether members of the comparison groups were themselves involved in start-up activity was unfortunately not asked of the mixed gender comparison group (the CG-ERC subsample). Follow-up interviews with these individuals revealed that four of them had in fact started businesses, and in subsequent analyses using the Sample dataset, these four individuals are dropped. Within the minority oversample comparison group (the CG-Min) subsample, a total of 29 individuals reported some start-up activity, so these individuals were also dropped in analyses using the Sample dataset. Details of the distribution of males and females for the various subsamples and descriptions of the decision rules for identifying nascent entrepreneurs is found in Shaver, Carter, Gartner and Reynolds (2001).

Because of the oversight about start-up activity in the comparison group, the CG-ERC subsample (2010 respondents) was dropped in analyses using the Screener. In addition, another 40 respondents were dropped from analyses using the Screener because of problems with various variables that made these cases suspect. Therefore, the Screener reports on analyses using 62,612 respondents.

To be labeled a "nascent entrepreneur" a respondent had to say, "yes" to either one or both of the following questions:

1. Are you, alone or with others, now trying to start a new business?
2. Are you, alone or with others, now starting a new business or new venture for your employer? An effort that is part of your job assignment?

Nascent entrepreneurs had to meet three additional criteria: (a) be currently active in the start-up effort, (b) anticipate full or part ownership of the new business, and (c) the effort could not have generated a positive monthly cash flow that covered all expenses and owner/manager salaries for more than three months.

The initial stage of the detailed interviews, completed by the University of Wisconsin Survey Research Laboratory, included the third criteria. Only the three-criteria nascent entrepreneurs received the full 60-minute phone interview and 12-page self-administered questionnaire. About one-fourth (27 percent) of the two-criteria nascent entrepreneurs were involved with baby businesses, new firms in the first stages of operational existence, and did not qualify as three-criteria nascents. Hence, the actual prevalence rate of three-criteria nascents would be about three-fourths of that of two-criteria nascents.

On the other hand, the three call-back criteria utilized in the initial screening—three calls to each randomly selected phone number—led to a lower prevalence rate. The prevalence rate for two-criteria nascent entrepreneurs among three call-back respondents was 6.2 per 100, compared with 7.5

per 100 for five to nine call-back respondents. This 21 percent higher prevalence rate is statistically significant.

These two sources of attrition may, therefore, offset each other. The prevalence rate of two-criteria nascent entrepreneurs with the three call-back operational criteria may be equal to the prevalence rate of three-criteria nascent entrepreneurs with the nine call-back operational criteria. The impact of more call-backs on the prevalence rate reflects the extreme time pressures on nascent entrepreneurs, most of whom have a full-time role in the labor force at the same time they are trying to start a new business. They are difficult to find and interview precisely because they are so busy trying to implement a new business.

Those that answered yes to either (6.1 percent to the first and 2.8 percent to the second) or both (1.2 percent) of these questions are then asked about the first two *a* + *b* of the three additional criteria. Analyses of population prevalence rates focus on these two-criteria nascent entrepreneurs.

About 87 percent of those respondents that met the *a* + *b* criteria provided their first name and phone number for subsequent survey efforts by the University of Wisconsin Survey Research Laboratory in Madison, Wisconsin.

A similar procedure was used to identify candidates for the comparison group, except that all respondents in the sample were offered a chance to participate in a "study of the work and career patterns of all Americans, including those not currently working." In this case, 62 percent agreed to participate.

In addition to providing candidates for the nascent entrepreneur cohort and the comparison group, the resulting dataset includes basic socio-demographic information on the respondents and their households, as well as the county and state in which the phone was located. This information is used in the analysis of factors affecting the prevalence rates of two-criteria nascents.

Respondents involved in several start-up efforts were asked to focus on only the most recent start-up effort. Up to one-third of the nascent entrepreneurs reported simultaneous participation in several start-ups. Four questions were used to determine if the start-up has NOT had positive monthly cash flow that covers expenses and owner-manager salaries for more than three months.

An infant business was a business in which the start-up effort had a positive monthly cash flow that covered expenses and salaries for the owner/

manager for more than three months (91 days). In the phone interview four questions were asked that were used to make this determination:

Question 162: first year in which money, income, or fees were received.
Question 164: first year in which there was positive monthly cash flow.
Question 165: whether business expenses included owner's salary.
Question 166: first year in which expenses included owner's salary.

Each of the "year" questions was followed by a corresponding "month" question (162a, 164a, 166a) to specify the timing more precisely.

If so, the effort is considered an infant business and not a start-up effort, and respondents are thanked for their time and dropped from the procedure. Approximately one-fourth (27 percent) of the respondents are dropped at this stage, reflecting the ambiguity associated with the phrase "starting a business."

Potential nascent entrepreneurs were more interested in volunteering for the project than those in the comparison group, 87 percent versus 62 percent; but those in the comparison group are more likely to complete all aspects of the data collection procedure; they had a 10 percent higher return rate on the mailed questionnaires.

The time and effort required to obtain completed phone interviews is indicated by the time lags between the initial screening and the phone interview, which averaged 51 days for nascent entrepreneurs and 62 days for the comparison group respondents, with a maximum of 250 days. It is also reflected in the lag between completion of the phone interview and receipt of the mail questionnaire, which averaged 51 and 37 days, respectively, for nascent entrepreneurs and comparison group respondents, with a maximum of 337 days. Further, the number of contacts required to obtain the phone interviews averaged 8 for nascent entrepreneurs and 5 for the comparison group, with a maximum of 74. Twenty-five percent of the nascent entrepreneur phone interviews required more than 9 calls and 25 percent of the comparison group phone interviews required more than 7 calls.

Reactions of the respondents were measured in several ways. Nascent entrepreneurs were asked, at the end of the phone interview, how the experience affected their interest in starting a new firm: 59 percent said it increased their interest, 39 percent said it had no effect, and 1.2 percent indicated that it reduced their interest in starting a new firm. In fact, the positive effect may cause some problems, for some may claim that participation in the project may increase both the interest and, because of the content of the interview schedules, the business knowledge of the nascent entrepreneur participants. This may improve their chances for business success. In a sense, the Heisenberg effect in research, that collecting data from a phenomenon takes energy from the process under study, may be offset by the Hawthorne effect, that a known research focus on work activity may lead to higher levels of work productivity.

The most difficult issue on which to obtain responses in survey research is information regarding household financial status. It is easier to obtain candid responses about drug use, deviant or extramarital sexual behavior, cheating on income tax returns, and almost any other personal activity. In this project, however, more than 95 percent of the nascent entrepreneurs and 98 percent of the comparison group provided information on both household income and net worth. On the self-administered questionnaires that were returned, 98 percent of the items are completed. In terms of respondent cooperation in survey research in the United States at the end of the twentieth century—this is as good as it gets!

The PSED Datasets

Analyses based on the full screening sample of 62,612 respondents are labeled as the Screener. Various analyses with the detailed data will reflect comparisons among three-criteria nascents of different ethnic backgrounds as well as with appropriate comparison group individuals. The unweighted counts of respondents by ethnic identification are indicated for the two types of analyses in Table 7A.2. Analyses that were conducted on the sample of 1,261 individuals that compose the nascent entrepreneurs and comparison group individuals are labeled Sample.

The attrition between the screening sample and the detailed data on nascent entrepreneurs reflects both losses during the data collection process and purposeful sampling from the screened population to enhance the female and minority detailed samples. The slight underrepresentation of Hispanics in the screening sample reflects the practice, for this study, of restricting all interviews to English.

Ethnic identity was determined in two different ways in the two surveys. In the screening interviews, individuals were asked two questions; one related to whether respondents considered themselves White, Black, Asian, or other. The second question asked whether respondents considered themselves Hispanic or Latino: yes or no. To create a single variable, any person who responded

Table 7A.2 Number of Respondents: By State of Data Collection and Ethnic Background

(Unweighted counts)	Screening sample: Not two-criteria nascent entrepreneurs	Screening sample: Two-criteria nascent entrepreneurs	Detailed sample: Three-criteria nascent entrepreneurs	Detailed samples: Comparison group
Whites	46,289	2,726	492	191
Blacks	5,156	547	210	139
Hispanics	3,519	258	57	69
Asians	1,016	53	11	6
Others	1,427	122	14	20
No information	1,431	68	46	6
Column totals	58,838	3,774	830	431
Total each sample		62,612 Screener		1,261 Sample

"White" or "Other" to the first item and "yes" to the Hispanic item was considered Hispanic. Of those in the Hispanic category, 44 percent responded, "White" to the first item; the remainder responded "Other." Among those retained in the "Black" category, 3 percent had responded "yes" to the Hispanic item as had 8 percent of those in the "Asian" category. The ethnic identification of the respondents is not, therefore, unambiguous in every case. In the detailed interview, each respondent answered a single item related to ethnic identification as White, Black, Hispanic, American Indian, Asian, etc. Among those in the detailed interviews classified as White, 92 percent were in the White category for the screening interviews; 94 percent of those who claimed Black and Hispanic in the detailed categories were in the same category for the screening interviews. It should be noted that some of this switching reflects a change in actual respondent reporting on the start-up effort, which is often a team initiative, with different members of the team (often spouses) interviewed at the two different points in the data collection process.

8 Regulatory Flexibility Act Implementation, FY 2006

Synopsis

Charged with overseeing implementation of the Regulatory Flexibility Act of 1980 (RFA) and Executive Order 13272, the Office of Advocacy reports annually on federal agency compliance. The RFA requires federal agencies, during the regulatory development process, to review the potential impact of proposed regulations on small businesses and other small entities and to examine significant alternatives that minimize small entity impacts while still meeting the purpose of the regulation. E.O. 13272, signed by President Bush in 2002, strengthened the implementation process by requiring agencies to post their RFA implementation procedures and policies publicly, ensuring Advocacy has an opportunity to review rules earlier in the process, and requiring Advocacy to train federal agencies in how to comply with the law.

Over the past several years, the Office of Advocacy has seen progress in agency understanding of and compliance with the RFA and E.O. 13272. Nearly all Cabinet departments have posted their RFA policies on their websites and more agencies are routinely notifying the office electronically of regulatory proposals. An increasing number of agencies are getting Advocacy involved earlier in the regulatory development process to ensure that they have done the work needed to address small business concerns. As a result of the law's implementation in FY 2006, small businesses saved $7.25 billion in the first year and $117 million in annually recurring costs.

One measure of the federal RFA's success that was apparent in FY 2006 was the number of state governments implementing laws modeled on it. The Office of Advocacy offered model legislation for the states in December 2002. With 19 state regulatory flexibility laws or executive orders already in effect as of FY 2005, 11 more states introduced RFA legislation in FY 2006, two states enacted it, and two more governors issued executive orders. By summer 2007, 37 state legislatures had considered RFA legislation and 22 had implemented it by law or executive order. A record of successful RFA implementation is now being built at the state level.

An Overview of the RFA and Related Policy

When Congress passed the Regulatory Flexibility Act (RFA) in 1980, it found, among other things, that

> …laws and regulations designed for application to large scale entities have been applied uniformly to small businesses, small organizations, and small governmental jurisdictions even though the problems that gave rise to government action may not have been caused by those smaller entities; uniform Federal regulatory and reporting requirements have in numerous instances imposed unnecessary and disproportionately burdensome demands including legal, accounting and consulting costs upon small businesses, small organizations, and small governmental jurisdictions with limited resources; [and] unnecessary regulations create entry barriers in many industries and discourage potential entrepreneurs from introducing beneficial products and processes.[1]

The 1980 passage of the RFA was intended to address this longstanding problem of the disproportionate economic impact of federal regulations on small businesses. The RFA refined the process by which regulations were promulgated under the Administrative Procedure Act (APA). By requiring agencies to consider the impact of their regulations on small entities, the RFA simultaneously addressed the disproportionate effect of those regulations and promoted the participation of small businesses in the rulemaking process.

Analysis under the RFA

The RFA does not require special treatment or regulatory exemptions for small businesses, but mandates that agencies develop an analytical process for determining how best to achieve public policy objectives without unduly burdening small entities. During the preparation of a proposed rule, an agency must prepare an initial regulatory flexibility analysis (IRFA) if it determines that a proposal may impose a "significant economic impact on a substantial number of small entities." The RFA requires agencies to publish the IRFA, or a summary thereof, in the *Federal Register* at the same time it publishes the

1 Regulatory Flexibility Act, Pub. L. No. 96-354 § 2, 94 Stat. 1164 (1980) (codified at 5 U.S.C. § 601). The full law as amended appears as Appendix B of this report.

proposed rulemaking.[2] An agency can waive the requirement for an IRFA if it can certify that the proposed rule will not have such an impact; such certifications must have a factual basis.[3]

Under section 603(b) of the RFA, an IRFA must describe the impact of the proposed rule on small entities and contain the following information:[4]

1. A description of the reasons why the action by the agency is being considered.
2. A succinct statement of the objectives of, and legal basis for, the proposed rule.
3. A description—and, where feasible, an estimate of the number—of small entities to which the proposed rule will apply.
4. A description of the projected reporting, recordkeeping, and other compliance requirements of the proposed rule, including an estimate of the classes of small entities that will be subject to the requirement and the types of professional skills necessary for preparation of the report or record.

An identification, to the extent practicable, of all relevant federal rules that may duplicate, overlap, or conflict with the proposed rule.

Each IRFA must also contain a description of any significant alternatives to the proposed rule that minimize the burden on small entities while still accomplishing the objective of the rule.[5] After the agency has collected the comments submitted in response to the proposed rule, it must publish a final regulatory flexibility analysis, or FRFA.[6] The FRFA must address, in light of the comments it has received, the same elements of the IRFA. The FRFA must also describe the steps followed by the agency to minimize the economic impact on small entities; give the factual, policy, and legal reasons

2 5 U.S.C. § 603.

3 5 U.S.C. § 605(b). This certification must be published with the proposed rule or at the time of the publication of the final rule in the *Federal Register* and is subject to public comment in order to ensure that the certification is warranted.

4 5 U.S.C. § 603(b).

5 5 U.S.C. § 603(c).

6 5 U.S.C. § 604.

for selecting the alternatives adopted in the final rule; and explain why other alternatives were rejected.[7]

By specifically analyzing the impact of proposed rules on small businesses and seeking their input, agencies can seek alternative measures to reduce or eliminate the disproportionate small business burden without compromising public policy objectives.

SBREFA, Judicial Review, Amicus Authority

In 1996, Congress passed the Small Business Regulatory Enforcement Fairness Act (SBREFA), which did several things to aid small businesses.[8] It increased the specificity of the already required economic analysis, and it required the Environmental Protection Agency (EPA) and the Occupational Safety and Health Administration (OSHA) to convene panels to consult with small entity representatives before proposing any rules expected to have a significant economic impact on those businesses.[9] These panels consist of representatives of the agency, the Office of Advocacy (Advocacy), the Office of Management and Budget's Office of Information and Regulatory Affairs (OIRA), and small entity representatives.[10] In addition to considering the agency's policies, data, and economic analysis, the panels also present this information to several small entity representatives, who provide written and verbal feedback to the agency. SBREFA also provided for small entities to seek judicial review of an agency's rulemaking if the agency failed to comply with the rulemaking provisions of the RFA, and gave the Small Business Administration's (SBA) chief counsel for advocacy enhanced authority to enter briefs in such cases as a friend of the court.[11]

Executive Order 13272

On August 13, 2002, President George W. Bush signed Executive Order 13272, which further spelled out the obligations of the RFA for the Office of Advocacy and federal agencies.[12] It required Advocacy to remind the heads

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7 Id. at § 604(a).

8 5 U.S.C. §§ 601-612 (2000).

9 5 U.S.C. §§ 609 (b), (d).

10 Id.

11 5 U.S.C. §§ 611(a), 612(b).

12 Exec. Order No. 13272, 67 *Fed. Reg.* 53,461 (Aug. 16, 2002), available on the Office of Advocacy website at http://www.sba.gov/advo/laws/eo13272.pdf. The full order is reprinted in this report in Appendix B.

of the agencies of their responsibilities under the RFA and to provide training to those agencies on how to comply. It further emphasized Advocacy's authority to comment on draft rules to the agency or to OIRA.

E.O. 13272 directed the agencies to issue written procedures and policies on how they comply with the RFA. Most federal agencies have posted their RFA procedures on their websites.[13] It also directed the agencies to notify Advocacy when a proposed rule would have a significant economic impact on a substantial number of small entities.[14] Under the executive order, each agency is required to give "every appropriate consideration" to comments it receives from Advocacy on proposed rules, and publish its response to Advocacy's comments with the final rule.[15]

Federal Agency Compliance and the Role of the Office of Advocacy

For more than 30 years, the Office of Advocacy has represented the concerns of small business before Congress and regulatory agencies. One of Advocacy's primary functions is to "examine the role of small business in the American economy…"[16] Congress tasked Advocacy with being an independent voice for small business[17] in 1976, and mandated that Advocacy measure the "direct costs and other effects of government regulations on small business…"[18] Four years later, the Regulatory Flexibility Act was enacted, requiring federal agencies to consider the impact of their regulations on small businesses and other small entities.[19] The law gave the chief counsel for advocacy the responsibility of reporting to the president and Congress on agency compliance with the law.[20] Executive Order 13272 further requires regulatory agencies to share drafts of proposed rules that may have a significant economic

13 See *id.* § 3(a).

14 See *id.* § 3(b).

15 See *id.* §3(c).

16 15 U.S.C. § 634(b).

17 15 U.S.C. § 631(a) (Declaration of Policy).

18 15 U.S.C. § 634(b)(3).

19 See supra, note 1.

20 5 U.S.C. § 612(a).

impact on a substantial number of small entities and to consider Advocacy's comments on those rules.[21]

The level of federal agency compliance with these two requirements continues to vary across agencies and departments. As this report indicates, fiscal year 2006 has led to numerous interventions by the Office of Advocacy on behalf of small businesses, saving them $7.25 billion in first-year costs and $117 million in annual recurring costs.[22] Clearly some agencies have not yet incorporated the RFA analytical process into their regulatory development. However, the Office of Advocacy sees improvement across the board in many other agencies. Those agencies have approached Advocacy earlier in the decision-making process in an effort to consider the regulatory impacts of their proposed regulations before a draft proposed rule is published in the *Federal Register*.

The RFA has been in existence for 26 years. SBREFA, the major amendment to the RFA, is now 10 years old. E.O. 13272 has been in effect for four years. Despite the age of these congressional and executive directives, agencies remain in need of assistance when it comes to considering small business concerns and analyzing potential economic impacts of their draft regulations on the small businesses they regulate. Consideration of these impacts is becoming less an afterthought for some federal agencies, yet a full and consistent understanding of the requirements of these important mandates remains elusive to others.

Agency Compliance with Executive Order 13272

E.O. 13272 contains three requirements for federal regulatory agencies. The first was completed, for the most part, in FY 2003, when Cabinet-level departments issued written policies and procedures describing how they will ensure that their regulations consider the potential impact on small entities. These documents were made publicly available on most department websites.[23]

The second requirement directs agencies to notify Advocacy of any draft rules that may have a significant economic impact on a substantial number of small entities under the RFA.[24] Such notifications are to be made either

21 See supra, note 3.

22 See Table 8.2 for a detailed summary of cost savings for FY 2006.

23 Exec. Order No. 13272 § 3(a).

24 See *id.* § 3(b).

when the agency submits a draft rule to OIRA under Executive Order 12866 or, if no such submission is required, at a reasonable time before publication of the rule by the agency.[25] Advocacy established an email address, notify.advocacy@sba.gov, to make it easier for agencies to comply electronically with the notice requirements of E.O. 13272 and the RFA. More agencies utilized the system in FY 2006. Instant communication enables agencies to work with Advocacy sooner rather than later, and Advocacy is committed to encouraging more agencies to abandon the paper notification system still used at a few remaining agencies.

The third requirement under E.O. 13272 is to give appropriate consideration to Advocacy's comments on a proposed rule.[26] In the final rule published in the *Federal Register*, an agency must respond to written comments submitted by Advocacy. Most agencies have either complied with this requirement or did not have an opportunity to comply in fiscal year 2006 because they did not issue a final rule on which Advocacy publicly commented.

RFA Training under E.O. 13272

One of the important requirements of the executive order is that Advocacy train every federal regulatory agency in how to comply with the RFA.[27] In FY 2006, the third year of training, economists, attorneys, and regulatory and policy staff at numerous agencies received detailed instruction on how to consider the impact of their regulations on small entities *before* they put pen to paper. This is an important step in helping them comply with the RFA and E.O. 13272.

Having identified 66 departments, agencies, and independent commissions that promulgate regulations affecting small businesses, the Office of Advocacy hopes to complete training of all 66 by FY 2008. Since the executive order was signed, Advocacy has trained more than 48 federal agencies, many on more than one occasion. Some federal agencies are considering making this training mandatory for all of their regulatory staff, which can include as many as 1,500 employees in some large agencies. With classroom

25 Exec. Order No. 12866, 58 *Fed. Reg.* 51,735 (Sept. 30, 1993) subjects any "significant regulatory action,"which generally means a rule that will have an annual effect on the economy of $100 million or more, to review by the OIRA. E.O. 12866 requires the agency to select the regulatory alternative that imposes the least burden on society consistent with maintaining an agency's regulatory objectives.

26 See *id.* §3(c).

27 Exec. Order No. 13272 § 2(b).

sessions ideally consisting of 25-30 students, it frequently takes many sessions at an agency to accomplish this task, but Advocacy has found that these smaller, more intensive sessions are the most productive for attendees.

Agency feedback following each training session continues to be excellent. A better test of the effectiveness of RFA training, however, is how agencies comply with the RFA once the training is complete. After training, most agencies are more willing to share draft documents with Advocacy in an effort to improve their RFA compliance. The difference is becoming apparent in regulatory certifications.[28] For the most part, agencies have learned that they must provide a factual basis for their assertion that a rule will not have a significant impact on a substantial number of small entities. It is now infrequent that these agencies issue boilerplate statements to that effect without an explanation in the proposed rule. This progress can be directly attributed to the RFA training sessions' focus on providing more information to small entities in the proposed rule and analyzing small entity impacts as early as possible in the rulemaking process.

Online RFA Training Completed

In fiscal year 2006, efforts were concentrated on the development and rollout of an online component to the RFA classroom training. Federal agency rule writers can now access an online training site to take the RFA course. New employees and those that need a refresher have valuable information on the RFA at their fingertips. Advocacy is hopeful that this enhanced training tool will help more agency staff fully understand the RFA compliance requirements and consider the small entity impacts of their rules. The online RFA training can be accessed at www.sba.gov/advo/regulatory/onlinetraining.html. [29]

Measuring Effectiveness

Historically, Advocacy has measured its achievements under the RFA through a calculation of regulatory cost savings. However, the cost savings figure does not begin to capture the totality of Advocacy's involvement in the rulemaking process. Under E.O. 13272, Advocacy has proven very suc-

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28 A regulatory certification is a promise by the head of an agency under 605(b) of the RFA that the rule when promulgated will not have a significant economic impact on a substantial number of small entities.

29 Advocacy's online training is designed for federal government employees, but has also been made available to the general public. Online visitors to the URL will be prompted to obtain a password from the Office of Advocacy prior to further accessing the training site.

cessful in its efforts to have agencies analyze a rule's impact on small businesses before the regulation is made public in the *Federal Register*. Many of Advocacy's greatest successes cannot be recounted or quantified publicly because of the importance of maintaining the confidentiality of interagency communication. Preproposal oral and written communications between Advocacy and agencies are kept confidential, and that helps the prepublication exchange of information between Advocacy and agencies. Often preproposal communications are where the greatest benefits are achieved in agency compliance with the RFA and in the choice of alternatives that lessen the rule's impact on small businesses.

The success of Advocacy's early intervention in the rulemaking process and its agency training under E.O. 13272 presented Advocacy with an interesting conundrum. How can Advocacy modernize the measurement of its effectiveness to encompass its ongoing regulatory interventions, determine the benefits of earlier intervention in the rulemaking process, and evaluate the success of agency training under E.O. 13272? Theoretically, as Advocacy achieves more success utilizing these tools and agencies become more proficient in complying with the RFA, cost savings between the first public proposal and the final rule should diminish.

Advocacy has recently undertaken an exploration of ways to increase its ability to gauge its effectiveness post-E.O. 13272. In future annual reports, Advocacy anticipates using new measurement tools to refine and increase information about its effectiveness in persuading federal agencies to comply with the RFA.

Overview of RFA Implementation

Advocacy promotes agency compliance with the RFA and E.O. 13272 in several ways throughout the rulemaking process. Advocacy attorneys and economists regularly review proposed regulations and work closely with small entities, trade associations, and federal regulators to identify areas of concern and to work to ensure that the RFA's requirements are fulfilled.

Advocacy provides a voice for the small business community early in the rulemaking process by putting the real-world concerns of small businesses directly in front of agency officials. Advocacy staff regularly meet with small businesses and their trade associations regarding federal agency responsibilities under the RFA, factors to be addressed in agency economic analyses, and the judicial review provision enacted in the SBREFA amendments.

Roundtable meetings with small businesses and trade associations focus on specific regulations and issues, such as environmental, transportation, and industrial safety regulations. Advocacy also plays a key role as a participant in SBREFA panels convened to review EPA and OSHA rules.

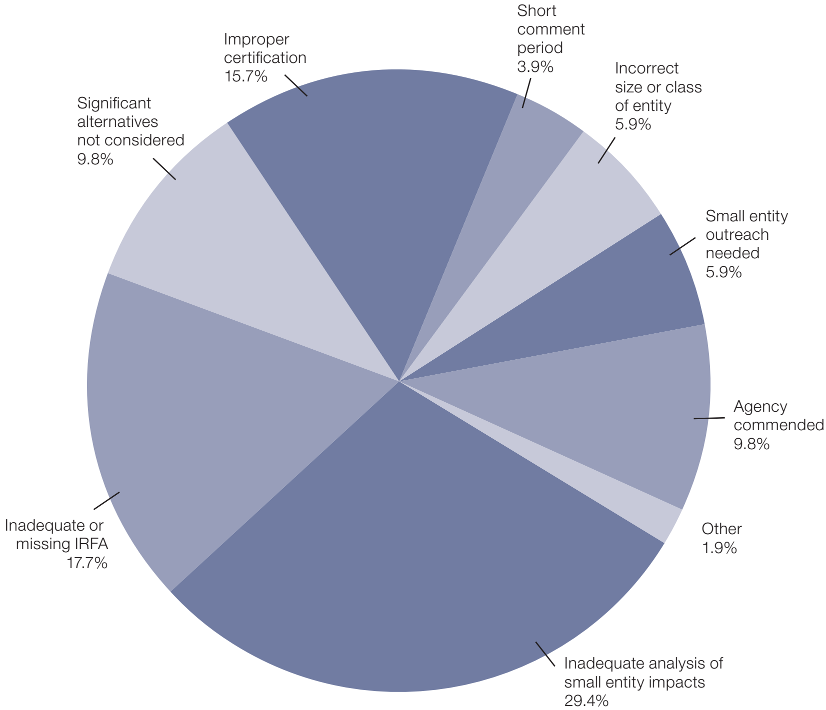
Advocacy's Office of Economic Research continues to provide economic data to help agencies identify industrial sectors dominated by small firms. Advocacy makes statistics available on its website and maintains a database of information on trade associations that can be helpful to federal agencies seeking input from small businesses.

As regulatory proposals and final rules are developed, Advocacy provides preproposal consultation, interagency review under E.O. 12866, informal comments to the agency, congressional testimony, and "friend of the court" amicus briefs. Advocacy also continues to review proposed regulations and send formal comment letters where appropriate. In FY 2006, Advocacy sent more than 40 formal comment letters to federal agencies (Figure 8.1 and Table 8.1).[30]

As a result of Advocacy interventions, quantifiable cost savings were achieved for small businesses in 16 regulations in FY 2006 (Table 8.2). Efforts to reduce the regulatory burden of these 16 rules resulted in FY 2006 foregone regulatory cost savings of $7.25 billion in first year and $117 million in annually recurring savings (Table 8.3).

30 Advocacy sent formal letters to agencies in response to a variety of agency actions including proposed rules, public notices, agency meetings, guidance documents, and requests for comments. Advocacy also sent letters to introduce reports and information from small business advocacy review panels and to highlight congressional testimony by Advocacy staff.

Figure 8.1 Advocacy Comments by Key RFA Compliance Issue, FY 2006 (percent)



Note: In fiscal year 2006, the Office of Advocacy provided comments to several agencies on how to comply with the RFA. Figure 8.1 illustrates key concerns raised by Advocacy's comment letters and prepublication review of draft rules. The chart highlights areas for improved compliance based on Advocacy's analysis of its FY 2006 comment letters and other regulatory interventions summarized in this report.

Table 8.1 Regulatory Comment Letters Filed by the Office of Advocacy, Fiscal Year 2006*

Date	Agency	Comment Subject
10/03/05	SEC	Comment letter regarding the Notice of Proposed Rulemaking extending small public company compliance deadlines for internal control reporting under the Sarbanes-Oxley Act of 2002, Section 404; 70 *Fed. Reg*. 56,825 (Aug. 30, 2005).
10/14/05	DOL	Comment letter regarding the Notice of Proposed Rulemaking on Form 5500 E-Filing Regulation; 70 *Fed. Reg*. 51,542 (Aug. 30, 2005).
10/28/05	FCC	Response letter to Public Notice Seeking Comment Regarding Possible Revision or Elimination of Rules under the Regulatory Flexibility Act, 5 U.S.C. Section 610; DA-05-154.
10/28/05	DOL/OSHA	Response letter to Public Notice of Regulatory Flexibility Act Section 610 Review of Lead in Construction Standard; 70 *Fed. Reg.* 32,739 (June 6, 2005).
10/31/05	DHS	Comment letter regarding the Advance Notice of Proposed Rulemaking on Documents Required for Travel within the Western Hemisphere; 70 *Fed. Reg.* 52,037 (Sept. 1, 2005).
11/14/05	EPA	Report of the Small Business Advocacy Review Panel convened for the Notice of Proposed Rulemaking on the Control of Hazardous Air Pollutants from Mobile Sources or Mobile Source Air Toxics (MSAT).
12/16/05	FWS	Comment letter regarding the Notice of Proposed Rulemaking for the Injurious Wildlife Species, the Black Carp; 70 *Fed. Reg.* 61,933 (Oct. 27, 2005).
01/03/06	IRS	Comment letter regarding the Notice of Proposed Rulemaking on Income Attributable to Domestic Production Activities; 70 *Fed. Reg.* 67,220 (Nov. 4, 2005).
01/06/06	OMB	Response letter to the Notice and Request for Comments on OMB's Proposed Bulletin for Good Guidance Practices; 70 *Fed. Reg.* 71,866 (Nov. 30, 2005).
01/09/06	OSHA	Comment letter regarding the Notice of Proposed Rulemaking on Electric Power Generation, Transmission, and Distribution, Electrical Protective Equipment Rule; 70 *Fed. Reg.* 34,822 (June 15, 2005).
01/13/06	EPA	Comment letter regarding the Notice of Proposed Rulemaking on the Toxics Release Inventory (TRI) Burden Reduction Rulemaking- Phase II; 70 *Fed. Reg.* 57,822 (Oct. 4, 2005).
01/18/06	FCC	Comment letter regarding the Notice of Proposed Rulemaking on the Junk Fax Prevention Act of 2005; CG Dkt. No. 05-338.
01/26/06	SEC	Response letter to the SEC's Advisory Committee on Smaller Public Companies' Draft Recommendations to Reform Section 404 of the Sarbanes Act of 2002.
02/01/06	FWS	Comment letter regarding the Notice of Proposed Rulemaking on the Designation of Critical Habitat of California Red-Legged Frog; 70 *Fed. Reg.* 66,906 (Aug. 4, 2005).
02/06/06	FAA	Comment letter regarding the Notice of Proposed Rulemaking on the Washington D.C. Metropolitan Area Special Flight Rules Area Rule; 70 *Fed. Reg.* 45,250 (Aug. 4, 2005).
02/10/06	EPA	Comment letter regarding the Notice of Proposed Rulemaking on Amendments to the Spill Prevention, Control and Countermeasure (SPCC); 70 *Fed. Reg.* 75,324 (Dec. 12, 2005).
03/14/06	EPA	Comment letter regarding the Proposed 2006 Multi-Sector General Permit (MSGP) for Industrial Facilities; 70 *Fed. Reg.* 72,116 (Dec. 1, 2005).

Table 8.1 Regulatory Comment Letters Filed by the Office of Advocacy, Fiscal Year 2006* —continued

Date	Agency	Comment Subject
03/14/06	FCC	Notice of ex parte presentation of recommendations to the FCC regarding the Junk Fax Prevention Act of 2005; CG Dkt. No. 05-338.
04/27/06	PTO	Comment letter regarding the Notice of Proposed Rulemaking on Changes to Practice for the Examination of Claims in Patent Applications; 71 *Fed. Reg.* 61 (Jan. 3, 2006); and Changes to Practice for Continuing Applications, Requests for Continued Examination Practice, and Applications Containing Patentably Indistinct Claims; 71 *Fed. Reg*. 48 (Jan. 3, 2006).
04/27/06	SEC	Response letter to Notice of Roundtable on Internal Control Reporting and Request for Comments on compliance experience with Section 404 of the Sarbanes-Oxley Act of 2002, File No. 4-511.
05/03/06	SEC	Statement to the House Committee on Government Reform regarding compliance experience with Section 404 of the Sarbanes-Oxley Act of 2002.
05/04/06	FSIS	Comment letter regarding the Notice of Proposed Rulemaking on the Availability of Lists of Retail Consignees during Meat or Poultry Recalls; 71 *Fed. Reg.* 11,326 (Mar. 7, 2006).
05/08/06	IRS	Comment letter regarding the Notice of Proposed Rulemaking on Escrow Accounts, Trusts and Other Funds Used During Exchanges of Like-Kind Property; 71 *Fed. Reg.* 6,231 (Feb. 7, 2006).
05/25/06	EPA	Comment letter regarding the Notice of Proposed Rulemaking on Lead; Renovation, Repair, and Painting Program; 71 *Fed. Reg.* 1,587 (Jan. 10, 2006).
05/30/06	Department of State	Comment letter regarding the Notice of Proposed Rulemaking on the Exchange Visitor Program, Training and Internship Programs; 71 *Fed. Reg*. 17,768 (April 7, 2006).
06/08/06	EPA	Response letter to EPA notification of May 26, 2006, regarding the Small Business Advocacy Review Panel for Non-Road Spark-Ignition Engines/ Equipment; List of Additional Small Entity Representatives (SERS).
06/08/06	OMB	Response letter regarding the OMB's Proposed Risk Assessment Bulletin; 71 *Fed. Reg*. 2,600 (Jan. 17, 2006).
06/09/06	IRS	Comment letter regarding the Final Rule on Income Attributable to Domestic Production; 71 *Fed. Reg.* 31,268 (June 1, 2006).
06/15/06	FCC	Response letter to proceeding on the Federal-State Joint Board on Universal Service, before the adoption of the final rule imposing Universal Service obligations on Voice over Internet Protocol providers; CC Dkt. No. 96-45;WC Dkt. No. 04-36.
07/05/06	TSA/Coast Guard	Comment letter regarding the Notice of Proposed Rulemaking on Joint Proposed Transportation Worker Identification Credential (TWIC) Implementation in the Maritime Sector Rule; 71 *Fed. Reg*. 29,396 (May 22, 2006).
07/06/06	FWS	Comment letter regarding the Notice of Availability of Draft Economic Analysis for the Proposed Designation of Critical Habitat for the Spikedace and Loach Minnow; 71 *Fed. Reg.* 32,496 (June 6, 2006).
07/17/06	SBA	Comment letter regarding the Notice of Proposed Rulemaking on the Women-Owned Small Business Federal Contract Assistance Program; 71 *Fed. Reg.* 34,550 (June 15, 2006).

Table 8.1 Regulatory Comment Letters Filed by the Office of Advocacy, Fiscal Year 2006* —continued

Date	Agency	Comment Subject
08/02/06	FWS	Comment letter regarding the Notice of Proposed Rulemaking on the Designation of Critical Habitat for the Five Endangered and Two Threatened Mussels in Four Northeast Gulf Mexico Drainages; 71 *Fed. Reg.* 32,745 (June 6, 2006).
08/03/06	PTO	Response letter to PTO's Request for Comments on Size Standard for Purposes of United States Patent and Trademark Office Regulatory Flexibility Analysis for Patent-Related Regulations; 71 *Fed. Reg.* 38,388 (July 6, 2006).
08/08/06	FCC	Comment letter regarding the Notice of Proposed Rulemaking and Initial Regulatory Flexibility Analysis on the Universal Service Contribution Methodology; WC Dkt. No. 06-122.
08/10/06	FWS	Comment letter regarding the Notice of Proposed Rulemaking on the Amended Designation of Critical Habitat for the Wintering Population of the Piping Plover; 71 *Fed. Reg.* 33,703 (June 12, 2006).
08/21/06	FCC	Notice of ex parte presentation of recommendations to the FCC regarding the Children's Television Obligations of Digital Television Broadcasters; CG Dkt. No. 00-167.
08/25/06	OSHA	Response letter to the notification (Aug. 16, 2006) on the Small Business Advocacy Review Panel on the Occupational Safety and Health Administration's draft proposal for Cranes and Derricks in Construction.
09/05/06	EPA	Comment letter regarding the Control Techniques Guidelines in Lieu of Regulations for Lithographic Printing Materials, Letterpress Printing Materials, Flexible Packaging Printing Materials, Flat Wood Paneling Coatings, and Industrial Cleaning Solvents; 71 *Fed. Reg.* 44,521 (Aug. 4, 2006).
09/07/06	FWS	Comment letter regarding the Notice of Revised Proposed Rulemaking and Notice of Availability of Draft Economic Analysis for the Designation of Critical Habitat for the Alabama Beach Mouse; 71 *Fed. Reg.* 44,976 (Aug. 8, 2006).
09/14/06	SEC	Comment letter regarding the Notice of Proposed Rulemaking on Extensions of Compliance Deadlines for Non-Accelerated Filers (Smaller Public Companies) for Section 404 of the Sarbanes-Oxley Act of 2002 (Internal Controls Financial Reporting); 71 *Fed. Reg.* 47,060 (Aug. 15, 2006).
09/15/06	SEC	Response letter to SEC's Concept Release on Forthcoming Management Guidance on Section 404 of the Sarbanes-Oxley Act of 2002 (Internal Controls Financial Reporting); 71 *Fed. Reg*. 40,865 (July 18, 2006).
09/15/06	EPA	Comment letter regarding the Notice of Proposed Rulemaking on the National Primary Drinking Water Regulations for Lead and Copper; 71 *Fed. Reg.* 40,827 (July 18, 2006).
09/18/06	FTC	Comment letter regarding the Notice of Proposed Rulemaking on the Identity Theft Red Flags and Address Discrepancies Under the Fair and Accurate Credit Transaction Act of 2003; 71 *Fed. Reg.* 40,785 (July 18, 2006).
09/20/06	FCC	Comment letter on the Notice of Proposed Rulemaking and Initial Regulatory Flexibility Analysis on the Implementation of the Commercial Spectrum Enhancement Act and Modernization of the Commission's Competitive Bidding Rules and Procedures; WT Dkt. No. 05-211.

*See the appendix at the end of this chapter for definitions of agency abbreviations. The complete text of Advocacy's regulatory comments is available on Advocacy's website, http://www.sba.gov/advo/laws/comments/.

Table 8.2 Regulatory Cost Savings, Fiscal Year 2006		
Agency	Subject Description	Cost Savings
CMS	*Outcome and Assessment Information Set:* The Centers for Medicare and Medicaid Services (CMS) published a final rule in 1999 requiring home health agencies (HHAs) that participate in the Medicare program to provide CMS with patient data called the Outcome and Assessment Information Set (OASIS). Advocacy commented in 1999 and 2000 voicing concern that implementation of the rule would increase the administrative and cost burden for a significant number of HHAs, the majority of which were small health care providers. On December 23, 2005, CMS published another final rule (70 *Fed. Reg.* 76,199) revising the requirements of the rule so that HHAs were no longer required to input patient-care data on non-Medicare/non-Medicaid patients.	CMS's delay of the effective date saved small HHAs $334 million. The December 2005 decision further netted an additional annual savings of $47.7 million. Source: National Association for Home Care & Hospice.
DOE	*Energy Conservation Standards for Distribution Transformers.* On August 4, 2006, the Department of Energy (DOE) published a proposed rule on energy conservation standards for distribution transformers. More than half of the manufacturers of liquid and medium-voltage dry distribution transformers are small businesses. In response to Advocacy's informal interagency comments, DOE considered the impacts on small business manufacturers when it proposed the least costly required efficiency standard from among five alternatives. DOE met with small businesses in designing the new efficiency standard and specifically chose a standard that would allow regulated manufacturers to make use of readily available techniques and materials.	This proposed standard results in one-time cost savings of at least $5 million. Source: DOE.
EPA	*Clean Water Act Section 316(b), Phase III Cooling Water Intake Structures.* On June 1, 2006, the U.S. Environmental Protection Agency (EPA) signed a final Clean Water Act rule designed to protect fish and other aquatic species from being killed when they are pulled into cooling water intakes. As originally planned by EPA, the rule would have required over 700 facilities to install devices to prevent aquatic losses, including an estimated 82 facilities owned by small entities. As a result of conducting a SBREFA review panel in early 2004, EPA concluded that facilities with relatively low intake flows typically do not cause aquatic losses, and EPA proposed an exemption for facilities that have a cooling water intake flow of 50 million gallons per day or less. This exemption, which is contained in the final rule, removes virtually all small businesses from the rule's coverage.	The recommendations of the SBREFA panel resulted in cost savings of $74 million for small entities such as municipal utilities, pulp and paper companies, and chemical plants. Source: EPA and American Public Power Association estimates.

Table 8.2 Regulatory Cost Savings, Fiscal Year 2006 —continued		
Agency	Subject Description	Cost Savings
EPA	*Spill Prevention Control and Countermeasures (SPCC).* EPA proposed a rule in December 2005 that would streamline requirements for oil spill prevention and planning for some facilities that store and use oil. EPA adopted Advocacy's recommendations for revisions in two areas: small facilities (under 10,000 gallons aggregate capacity for oil) and oil-filled equipment. EPA proposed that the requirements for small facilities be streamlined, which allows the facilities to self-certify compliance with the SPCC requirements, instead of using a professional engineer. It also permits additional flexibility for tank integrity testing and security requirements. Facilities with oil-filled equipment are provided the option of preparing an oil spill contingency plan and a written commitment of manpower, equipment, and materials in lieu of providing expensive secondary containment around the equipment.	These changes produced small business cost savings amounting to $46 million annually. Source: EPA.
EPA	*Toxics Release Inventory - Phase II Burden Reduction.* EPA proposed a rule in October 2005 that would allow short-form annual reporting of over 650 chemicals and classes of chemicals by industrial facilities. EPA adopted Advocacy's recommendation to reduce small business reporting burden by expanding the availability of the short form (Form A) to a larger universe of reporters of non-PBT (persistent bioaccumulative and toxic) chemicals, raising the threshold of the "annual reportable amount" from 500 pounds to 5,000 pounds. EPA also made Form A available to PBT reporters with zero total releases, and less than 500 pounds PRA (PBT reportable amount). These changes reduce small business reporting burden while maintaining the integrity of the Toxics Release Inventory database.	These changes created small business cost savings amounting to $7.4 million annually. Source: EPA.
EPA	*Clean Air Act Requirements to Control Mobile Source Air Toxics (MSAT).* On March 29, 2006, EPA published a proposed Clean Air Act rule that would require petroleum refineries to reduce concentrations of benzene, an air toxic, in gasoline. The rule would also require portable gasoline container manufacturers and light-duty highway vehicles to reduce the amount of benzene that is lost through evaporation. As a result of the recommendations from a SBREFA panel in September 2005, EPA proposed several flexibilities for small refiners, small gasoline container manufacturers, and light-duty vehicle manufacturers. These flexibilities include additional lead time for compliance; allowing a benzene averaging, banking, and trading program for refiners; and allowing a refiner or manufacturer that can demonstrate economic hardship additional time to comply with the standard.	The delayed implementation is estimated to result in $12 million in first year cost savings and $12 million in annual cost savings for the following four years. Source: Advocacy estimate based on EPA regulatory impact analysis.

Table 8.2 Regulatory Cost Savings, Fiscal Year 2006 —continued		
Agency	Subject Description	Cost Savings
EPA	*Resource Conservation and Recovery Act; RCRA Burden Reduction Rule.* On April 4, 2006, EPA published a final rule that reduces many of the paperwork burdens currently imposed by the Resource Conservation and Recovery Act (RCRA). EPA promulgated the burden reduction rule in response to recommendations from Advocacy and small business representatives to streamline burdensome requirements that have little corresponding environmental benefit.	The final rule is estimated to result in annual cost savings of $3 million per year. Source: EPA.
FAA	*Thermal/Acoustic Insulation Installed on Transport Category Airplanes.* The Federal Aviation Administration (FAA) proposed (in 2000) and then finalized (in 2003) a rule that established new flammability and fire protection standards for thermal/acoustic insulation in transport category airplanes. FAA issued guidance on the new rule in 2005 that would have rendered whole inventories of spare parts unusable, and also required testing and certification of all new, conforming parts before they could be installed on an aircraft. FAA agreed that the language in the rule was broader than intended and issued this new final rule to narrow its scope. The new rule specifically limits the scope to (1) newly manufactured aircraft and (2) only the thermal blankets and insulation around the ventilation ducts in existing aircraft. All other existing spare parts were excluded.	$74 million was saved in certification and testing costs, and $75 million in inventoried spare parts. Source: Industry estimates.
FDA	*Prescription Drug Marketing Act of 1987; Prescription Drug Amendments of 1992; Policies, Requirements, and Administrative Procedures.* In December 1999, the Food and Drug Administration (FDA) published a final rule that set forth requirements for the re-importation and wholesale distribution of prescription drugs in the United States. The rule was to become effective on December 4, 2000. Advocacy filed comments suggesting that the rule would negatively affect small distributors and wholesalers of prescription drugs who were required to provide and maintain information on the pedigree of the drugs. FDA chose to delay the effective date of the rule several times. On June 14, 2006, the FDA published a notice that the effective date would be December 1, 2006. Advocacy has generated cost savings to stakeholders from December 4, 2000 to February 2004, the last date on which the FDA delayed the effective date of the rule, but no data are available on the cost savings generated.	No data are available on cost savings.
FWS	*Critical Habitat, Canada Lynx.* On November 9, 2005, the Fish and Wildlife Service (FWS) proposed to designate 26,935 square miles of land as critical habitat for the Canada lynx. Advocacy met with FWS to discuss this rule. On February 16, 2006, the agency revised this proposed designation by decreasing the critical habitat designation (CHD) to 18,031 square miles. The proposed CHD excludes land in the state of Washington (1,693 square miles) and in Idaho and Montana (7,211 square miles).	FWS's proposed decision to exclude these high-cost areas from its CHD will result in $6 million in cost savings. Source: FWS.

Table 8.2 Regulatory Cost Savings, Fiscal Year 2006 —continued

Agency	Subject Description	Cost Savings
FWS	*Critical Habitat, Red Legged Frog*. On April 13, 2006, the FWS published a final rule as part of its final designation of critical habitat for the California red-legged frog. Following the issuance of a proposed rule in November 2005 revising the designation of the critical habitat for the California red-legged frog, Advocacy recommended in a comment letter on February 1, 2006, that FWS give meaningful consideration to excluding high-cost areas from its final designation. In its final rule, FWS addressed Advocacy's concerns and excluded approximately 250,329 acres from this final designation on the basis of potential disproportionately high economic cost.	FWS's decision to exclude these high-cost areas from its final designation resulted in $396 million in cost savings over 20 years. Source: FWS.
NHTSA	*Federal Motor Vehicle Safety Standard (FMVSS) No. 139.* In June 2003, the National Highway Traffic Safety Administration (NHTSA) published Federal Motor Vehicle Safety Standard (FMVSS) No. 139, which contained new requirements for passenger car tires and other vehicles with a gross weight of 10,000 pounds or less. NHTSA received several petitions for reconsideration of the final rule; among those petitions was a request by Denman Tires (the only manufacturer of specialty radial tires and the only small manufacturer) that such tires be subject to a less expensive testing requirement. Denman's petition was supported by comments submitted by the Specialty Equipment Market Association and by Advocacy. Upon reconsideration, the agency found that the more rigorous testing procedures under FMVSS 139 would have been prohibitively expensive, and that Denman's products could remain subject to the testing procedures of other motor vehicle safety standards.	This decision saved the only small business affected by the new safety standard an estimated $1.6 million in the first year alone. Source: Specialty Equipment Market Association.
NPS	*Personal Watercraft Rule*. On September 8 and 21, 2006, the National Park Service (NPS) reopened the Cape Lookout National Seashore and the Curecanti National Recreation Area to personal watercraft use. On March 21, 2000, the NPS created regulations that banned personal watercraft use in all national parks, which took effect in 2002. Advocacy has worked with NPS and representatives of the personal watercraft industry to reopen the national parks to personal watercraft use since 2002, and has been successful in reopening 11 other national parks since 2003.	Park openings will create $1 million in cost savings in the first year of the reopening. Source: NPS.
OSHA	*Occupational Exposure to Hexavalent Chromium.* OSHA proposed (in 2004) and then finalized (in 2006) a rule that lowers the permissible exposure limit (PEL) for airborne exposure to hexavalent chromium. Advocacy was highly involved throughout the rulemaking process. Advocacy participated in a SBREFA panel that reviewed the draft rule before it was published and recommended several changes to reduce the cost to small businesses. Because of these recommendations, OSHA established a PEL (or concentration not to be exceeded) of 5 µg/m3 and excluded Portland cement, chromium copper arsenate, and industries with very low exposures. OSHA also provided exceptions for intermittent users and large aircraft painting.	Quantifiable cost savings to small business totaled $520 million. OSHA allowed a four-year phase-in of engineering controls, which provide other significant, but unquantified, cost savings. Source: OSHA.

Table 8.2 Regulatory Cost Savings, Fiscal Year 2006 —continued		
Agency	Subject Description	Cost Savings
PHMSA	*Wetlines*. The Pipeline and Hazardous Materials Safety Administration (PHMSA) issued a proposed rule in December 2004 regulating external product piping (wetlines) on cargo tank motor vehicles. The rule limited to one liter the amount of flammable liquid that could remain in each wetline after drainage. Advocacy worked with small businesses and trade associations to analyze the potential impacts of the proposed regulation. In June 2006, having determined that "further regulation would not produce the level of benefits we originally expected and that the quantifiable benefits of proposed regulatory approaches would not justify the corresponding cost," the agency withdrew its notice of proposed rulemaking.	PHMSA's decision to withdraw the rule resulted in $39.4 million in first-year cost savings and $1.15 million in recurring annual savings. Source: PHMSA.
SEC	*Section 404 of the Sarbanes-Oxley Act of 2002. Extension of Small Public Company Compliance Deadline for New Internal Control Reporting Requirement*. In response to one recommendation by the Securities and Exchange Commission's (SEC) advisory committee on smaller public companies, on August 9, 2006, the SEC proposed to provide small businesses an extension of time to implement Section 404 of the Sarbanes-Oxley Act of 2002. Advocacy has worked with the SEC on the act since 2002. This rule was discussed in the OMB *2004 Report to Congress on the Costs and Benefits of Federal Regulations* as a candidate for regulatory reform because of its impact on small business.	SEC's proposed action is estimated to save smaller public companies $5.53 billion in compliance costs. Source: Industry estimates.
TSA/ USCG	*Transportation Worker Identification Credential (TWIC)*. On August 21, 2006, the Transportation Security Administration (TSA) and the U.S. Coast Guard issued a notice in the *Federal Register* indicating that facility and vessel owners will not be required to purchase or install card readers during the initial implementation of the TWIC in the maritime sector. While the notice references letters from Congress, the issues of the cost and technological feasibility of the reader requirements were raised during Advocacy's small business roundtable on the subject and in its comment letter to the agencies on the proposed rule.	The removal of the card "reader" requirements generates $129.2 million in small business cost savings. Source: TSA.

Table 8.3 Summary of Cost Savings,[1] FY 2006 (dollars)		
Rule / Intervention	First-Year Costs	Annual Cost
CMS- OASIS[2]	333,995,252	47,713,607
DOE-Energy Conservation Standards for Distribution Transformers[3]	5,000,000	
EPA-Cooling Water[4]	74,000,000	
EPA SPCC Rule-Proposal[5]	46,000,000	46,000,000
EPA Toxics Release Inventory - Phase II Burden Reduction – Proposal[5]	7,400,000	7,400,000
EPA-Clean Air Act Requirements to Control Mobile Source Air Toxics (MSAT)[6]	12,000,000	12,000,000
EPA-Resource Conservation and Recovery Act - RCRA Burden Reduction Rule[5]	3,000,000	3,000,000
FAA Thermal/Acoustic Insulation Installed on Transport Category Airplanes Final[7]	149,000,000	
FWS- Critical Habitat-Canada Lynx[8]	6,000,000	
FWS- Critical Habitat-Red Legged Frog[8]	396,000,000	
NHTSA-Federal Motor Vehicle Safety Standard (FMVSS) No. 139[9]	1,600,000	
NPS- Personal Watercraft Rule[10]	1,000,000	
OSHA-Occupational Exposure to Hexavalent Chromium[11]	519,915,259	
PHMSA-Wet Lines[12]	39,358,025	1,149,785
SEC-Section 404 Sarbanes-Oxley Act of 2002 - 17-month extension[13]	5,528,973,325	
TSA- Transportation Worker Identification Credential[14]	129,214,189	
Total	7,252,506,050	117,263,392

1 The Office of Advocacy generally bases its cost savings estimates on agency estimates. Cost savings for a given rule are captured in the fiscal year in which the agency agrees to changes in the rule as a result of Advocacy's intervention. Where possible, the savings are limited to those attributable to small business. These are best estimates. First-year cost savings consist of either capital or annual costs that would be incurred in the rule's first year of implementation. Recurring annual cost savings are listed where applicable.

2 *Source:* Advocacy calculations based on industry data from the National Association for Home Care & Hospice.

3 *Source:* DOE.

4 *Source:* EPA and APPA.

5 *Source:* EPA.

6 *Source:* Office of Advocacy estimate based on EPA regulatory impact analysis.

7 *Source:* Industry estimates.

8 *Source:* FWS.

9 *Source:* Specialty Equipment Market Association.

10 *Source:* NPS.

11 *Source:* OSHA.

12 *Source:* PHMSA.

13 *Source:* SEC data (updated in 2005) and Advocacy's 2002 calculation.

14 *Source:* TSA.

Making the States Flexible: Small Business Regulatory Flexibility Model Legislation Initiative

More than 93 percent of businesses in every state are small businesses, and they face a disproportionate share of the costs and burdens of regulation. Regulatory flexibility encourages agencies to develop an analytical process for determining how public policy goals can best be achieved without erecting unnecessary barriers to competition, stifling innovation, or imposing undue burdens on small businesses. In doing so, it seeks to level the playing field for small entities.

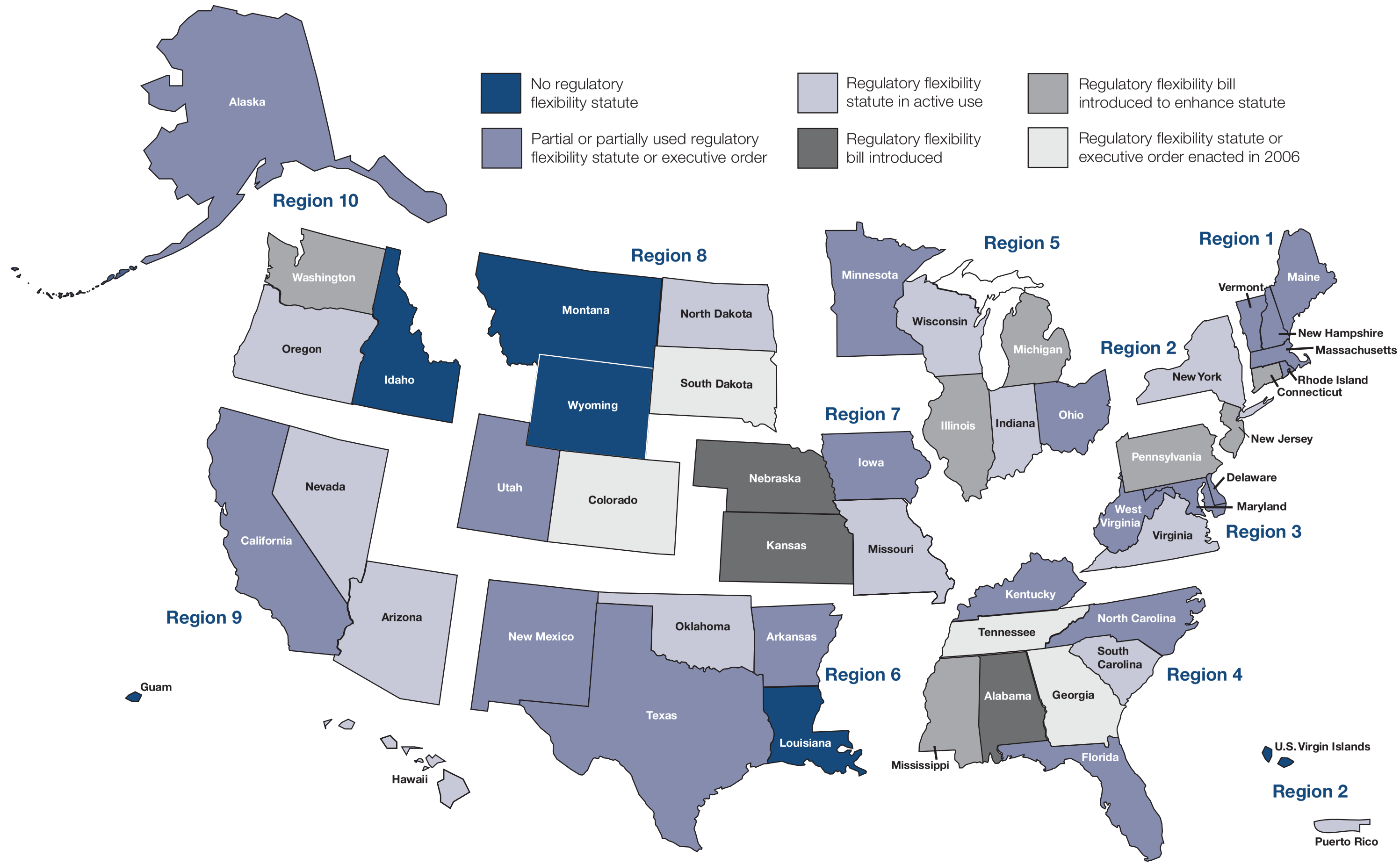
To be successful, the practice of regulatory flexibility must be effective at both the federal and state levels. Recognizing that fundamental changes were needed in the regulatory and enforcement culture of state agencies to make them more responsive to small businesses, the Small Business Administration's Office of Advocacy drafted model legislation for the states that mirrors the federal Regulatory Flexibility Act. The intent of the model legislation is for state agencies to seek to achieve statutory goals as effectively and efficiently as possible without imposing unnecessary burdens on small employers.

Successful state-level regulatory flexibility laws, as in the model legislation, address the following areas: 1) a small business definition that is consistent with state practices and permitting authorities; 2) a requirement that state agencies prepare a small business economic impact analysis before they regulate; 3) a requirement that state agencies consider less burdensome alternatives for small business that still meet the agency objective; 4) judicial review of agency compliance with the rulemaking procedures; and 5) a provision that forces state governments to periodically review existing regulations.

A number of state policymakers have supported and passed legislation to improve state rulemaking by creating procedures to analyze the availability of more flexible regulatory approaches for small business. Since 2002 when Advocacy's model legislation was introduced, 37 state legislatures have considered regulatory flexibility legislation and 22 states have implemented legislation or an executive order (See Figure 8.2).

In 2006, 11 states introduced regulatory flexibility legislation (Alabama, Colorado, Illinois, Kansas, Michigan, Mississippi, Nebraska, New Jersey,

Figure 8.2 Mapping State Regulatory Flexibility Provisions, FY 2006



Pennsylvania, South Dakota and Washington) (See Tables 8.4 and 8.5). Four states enacted legislation or implemented an executive order (Colorado, Georgia (EO), South Dakota, and Tennessee (EO)).

The following is a real life example that demonstrates the value to small businesses of regulatory flexibility at the state level.

In February 2005, Arkansas Governor Mike Huckabee signed Executive Order (EO) 05-04, requiring agencies to evaluate the economic impact of proposed regulations on small businesses and to consider less burdensome alternatives. Also under the EO, agencies were obligated to submit this analysis to the Arkansas Department of Economic Development (ADED) Small and Minority Business Unit, which is responsible for the oversight of the state's regulatory flexibility program.

During the 2005 General Assembly, a law passed requiring the Arkansas Department of Labor (DOL) to license elevator contractors, elevator mechanics, and elevator inspectors. Additionally, the Elevator Safety Board, within the DOL, was in the process of updating its regulations for the first time in 10 years. Outdated regulations often resulted in contractors having to obtain variances, through a cumbersome process, simply to utilize newer technologies recognized in the latest nationally recognized safety code, the American Society of Mechanical Engineers' (ASME) Codes for Elevators and Escalators.

As the Elevator Safety Board and the agency proceeded through the regulatory flexibility process, it was apparent that there were two expensive compliance issues for small business. First, elevators installed from 1963 to 1973, which previously had not been required to install fire service, were going to be required to do so under the revised rules. The Safety Division found that there were approximately 337 elevators in Arkansas that could be affected, and of those, 200 were located in small businesses. The cost to install the fire service was estimated at approximately $10,000 per elevator.

The second compliance issue dealt with a retrofit requirement for hydraulic elevators that have a flat-bottom hydraulic jack, or a single-bottom cylinder. The most recent ASME code required the replacement of the cylinder with a double cylinder or a cylinder with a safety bulkhead to prevent the elevator from falling if an in-ground cylinder ruptured. The agency intially estimated that approximately 350 elevators installed prior to 1980 might be affected, and of those, 208 were located in small businesses. The least expensive retrofit would cost approximately $10,000 per elevator.

Table 8.4 State Regulatory Flexibility Legislation, 2006 Legislative Activity		
Four states enacted regulatory flexibility legislation or an executive order in 2006		
Colorado (HB 1041)	South Dakota (SB 74, SB 75)	
Georgia (EO)	Tennessee (EO)	
Eleven states introduced regulatory flexibility legislation in 2006		
Alabama (HB 320)	Michigan (HB 5849 /HB 5850/ HB 5812)	Pennsylvania (HB 236/SB 842) ‡
Connecticut (HB 1041)	Mississippi (HB 1113/ SB 2881)	South Dakota (SB 74/SB 75)
Illinois (HB 5388)	Nebraska (LB 1170)	Washington (HB 1445)
Kansas (HB 2821)	New Jersey (A 2327/SB 1335)	

‡ This bill was introduced in 2005 and continued to be active

Table 8.5 State Regulatory Flexibility Legislation, Status as of October 2006			
13 states and one territory had active regulatory flexibility statutes			
Arizona	Missouri *	Oklahoma	Virginia *
Connecticut	Nevada	Oregon *	Wisconsin
Hawaii	New York	Puerto Rico	
Indiana *	North Dakota	South Carolina	
29 states had partial or partially used regulatory flexibility statutes			
Alaska *	Iowa	New Hampshire	Texas
Arkansas (EO) *	Kentucky	New Jersey	Utah
California	Maine	New Mexico *	Vermont
Colorado	Maryland	North Carolina	Washington
Delaware	Massachusetts	Ohio	West Virginia
Florida	Michigan	Pennsylvania	
Georgia	Minnesota	Rhode Island1	
Illinois	Mississippi	South Dakota1	
7 states, 2 territories, and the District of Columbia had no regulatory flexibility statutes			
Alabama	Idaho	Montana	Wyoming
District of Columbia	Kansas	Nebraska	
Guam	Louisiana	Virgin Islands	

* In 2005, the state enacted regulatory flexibility legislation on an executive order.

As the agency received input from the ADED Small and Minority Business Unit, a third issue was identified. Small speciality installation contractors felt that it was overly burdensome to license and test their employees in the same manner as a mechanic working for a larger company. They argued that elevator mechanics who only install wheelchair accessibility lifts should not be subject to the same stringent testing as a mechanic who installs a commercial elevator in a high-rise building.

As a result of the Arkansas regulatory flexibility law, the Elevator Safety Board and DOL received comments and input from the ADED Small and Minority Business Unit and a number of other small businesses. Each party recognized the public safety issues involved and approached the process in a cooperative manner. The final regulations, effective September 1, 2006, reflected this collaborative process, and flexible regulatory methods were utilized.

Owners of elevators without fire service or with a flat-bottom hydraulic jack were given five years to come into compliance. The regulations allow for an exception from these requirements if undue hardship is shown and reasonable safety is assured. Also, a restricted class of license was created for elevator mechanics that exclusively install wheelchair accessibility lifts with a less stringent testing requirement.

This example demonstrates a how a strong regulatory flexibility law facilitates a working relationship between small business stakeholders and regulating agencies. The result is a set of rules that will be less harmful to small business while still accomplishing the agency goal of elevator safety.

While reforming the process by which state regulations are developed and adopted is a critical first step, many states have learned that the hard work does not stop there. Once the legislation is passed, implementation of a successful state regulatory flexibility system relies on three elements: agency education in the law's provisions; small business education about the law and encouragement to become active in the rulemaking process; and continued executive support and leadership.

Advocacy continues to work with the small business community, state legislators, and state government agencies to assist with the implementation of the new law and to ensure its effectiveness. In the fall of 2006, Advocacy began developing a state best practices guide and organizing a conference of state policymakers, government officials, and small business advocacy groups from across the country. The purpose of this event, held in March 2007, was to share the tools and methodologies that have been developed to successfully implement state regulatory flexibility laws.

The Office of Advocacy is strengthened by regional advocates located in the Small Business Administration's 10 federal regions across the country. These accomplished individuals are Advocacy's direct link to small business owners, state and local government bodies, and organizations that support the interests of small entities. The regional advocates provide information on the status of regulatory flexibility in their region, assist with the passage and implementation of regulatory flexibility laws, and help to ensure the law's effectiveness. Regional advocate contact information can be accessed at http://www.sba.gov/advo/laws/law_modeleg.html.

Conclusion

Uniform regulatory and reporting requirements can impose unnecessary and disproportionately burdensome demands on small businesses with limited resources. The failure of state agencies to recognize differences in the scale and resources of regulated businesses can adversely affect competition in the marketplace, discourage innovation, and restrict improvements in productivity. Many states have some form of regulatory flexibility laws on the books. However, many of these laws do not contain all five critical elements addressed in Advocacy's model legislation. Recognizing that some laws are missing key components that give regulatory flexibility its effectiveness, legislators continue to introduce legislation to strengthen their current systems. In states that have passed strong legislation, Advocacy continues to recognize enthusiasm among state officials and advocacy groups in developing tools that will ensure the law's effectiveness.

Appendix: Abbreviations of Agency and Organization Names

AFPA	American Forest Products Association
AMS	Agricultural Marketing Service
APPA	American Public Power Association
APHIS	Animal and Plant Health Inspection Service
BIS	Bureau of Industry and Security
CIBO	Council of Industrial Boiler Owners
CMS	Centers for Medicare and Medicaid Services
DHS	Department of Homeland Security
DOC	Department of Commerce
DOD	Department of Defense
DOE	Department of Energy
DOI	Department of the Interior
DOJ	Department of Justice
DOL	Department of Labor
DOT	Department of Transportation
EBSA	Employee Benefits Security Administration
EMA	Engine Manufacturers Association
EPA	Environmental Protection Agency
ESA	Employment Standards Administration
FAA	Federal Aviation Administration
FCC	Federal Communications Commission
FDA	Food and Drug Administration
FDIC	Federal Deposit Insurance Corporation
FMCSA	Federal Motor Carrier Safety Administration
FRA	Federal Railroad Administration
FRS	Federal Reserve System

FTC	Federal Trade Commission
FWS	Fish and Wildlife Service
GSA	General Services Administration
GIPSA	Grain Inspection, Packers and Stockyard Administration
HHS	Department of Health and Human Services
HUD	Department of Housing and Urban Development
IRS	Internal Revenue Service
MSHA	Mine Safety and Health Administration
MMA	Medicare Prescription Drug Improvement and Modernization Act
NANC	North American Numbering Council
NATM	National Association of Trailer Manufacturers
NEFMC	New England Fishery Management Council
NHTSA	National Highway Traffic Safety Administration
NMFS	National Marine Fisheries Service
NOAA	National Oceanic and Atmospheric Administration
NTCA	National Telecommunications Cooperative Association
OCC	Office of the Comptroller of the Currency
OIRA	Office of Information and Regulatory Affairs
OMB	Office of Management and Budget
OSHA	Occupational Safety and Health Administration
OTS	Office of Thrift Supervision
PACA	Perishable Agricultural Commodities Act
RSPA	Research and Special Programs Administration
RVIA	Recreational Vehicle Industry Association
SBA	Small Business Administration
SEC	Securities and Exchange Commission
TSA	Transportation Security Administration
USDA	United States Department of Agriculture
VA	Department of Veterans Affairs

APPENDIX A

Small Business Data

Table A.1 Business Counts, 1985-2006				
Year	Employer f\irms	Nonemployers	Self-employed. (thousands)	Nonfarm business tax returns
2006	6,080,000 e.	20,740,700 e.	10,586	30,226,600 e.
2005	5,995,200 e.	20,392,068	10,464	29,512,000 e.
2004	5,885,784	19,523,741	10,431	28,695,500
2003	5,767,127	18,649,114	10,295	27,486,700
2002	5,697,759	17,646,062	9,926	26,434,300
2001	5,657,774	16,979,498	10,109	25,605,900
2000	5,652,544	16,529,955	10,215	25,007,500
1999	5,607,743	16,152,604	10,087	24,448,400
1998	5,579,177	15,708,727	10,303	24,113,000
1997	5,541,918	15,439,609	10,513	23,645,200
1996	5,478,047	NA	10,489	23,240,700
1995	5,369,068	NA	10,482	22,479,000
1994	5,276,964	NA	10,648	21,990,300
1993	5,193,642	NA	10,279	21,280,300
1992	5,095,356	14,325,000	9,960	20,849,200
1991	5,051,025	NA	10,274	20,517,000
1990	5,073,795	NA	10,097	20,052,900
1989	5,021,315	NA	10,008	19,560,700
1988	4,954,645	NA	9,917	18,619,400
1987	NA	NA	9,624	18,351,400
1986	NA	NA	9,328	17,524,600
1985	NA	NA	9,269	16,959,900

NA = Not available
Sources: U.S. Small Business Administration, Office of Advocacy, from data provided by sources below: employer firms from the U.S. Census Bureau with 2004 and 2005 estimates based on U.S. Census Bureau and Department of Labor data; nonemployers from the U.S. Census Bureau with 2004 and 2005 Advocacy estimates based on IRS data; self employment (unincorporated, primary occupation, monthly averages) from the Bureau of Labor Statistics; nonfarm business tax returns from the Internal Revenue Service.

Table A.2 Business Turnover, 1985-2006					
Year	Employer births		Employer terminations		Business bankruptcies
2006	649,700	e.	564,900	e.	19,695
2005	653,100	e.	543,700	e.	39,201
2004	628,917		541,047		34,317
2003	612,296		540,658		35,037
2002	569,750		586,890		38,540
2001	585,140		553,291		40,099
2000	574,300		542,831		35,472
1999	579,609		544,487		37,884
1998	589,982		540,601		44,367
1997	590,644		530,003		54,027
1996	597,792		512,402		53,549
1995	594,369		497,246		51,959
1994	570,587		503,563		52,374
1993	564,504		492,651		62,304
1992	544,596		521,606		70,643
1991	541,141		546,518		71,549
1990	584,892		531,400		64,853
1989	NA		NA		62,449
1988	NA		NA		62,845
1987	NA		NA		81,463
1986	NA		NA		79,926
1985	NA		NA		70,644

NA = Not available

Sources: U.S. Small Business Administration, Office of Advocacy, from the following data sources: employer births and terminations from the U.S. Census Bureau with 2004 and 2005 estimates based on U.S. Census Bureau and Department of Labor data; bankruptcies from the Administrative Office of the U.S. Courts (business bankruptcy filings).

Table A.3 Macroeconomic Indicators, 1995-2006					
					Percent change
	1995	2000	2005	2006	2005-2006
Gross domestic product (GDP) (billions of dollars)[1]					
Current dollars	7,397.7	9,817.0	12,455.8	13,246.6	6.3
Constant dollars (billions of 2000 dollars)	8,031.7	9,817.0	11,048.6	11,415.3	3.3
Sales (billions of dollars)[2]					
Manufacturing	290.0	350.7	378.7	396.2	4.6
Wholesale trade	176.2	234.5	298.8	329.3	10.2
Retail trade	189.0	249.1	307.8	325.4	5.7
Income (billions of dollars)					
Compensation of employees[3]	4,193.3	5,782.7	7,030.3	7,489.5	6.5
Nonfarm proprietors' income	469.5	705.7	940.4	992.5	5.5
Farm proprietors' income	22.7	22.7	30.2	22.6	-25.2
Corporate profits[4]	696.7	817.9	1,330.7	1,615.7	21.4
Output and productivity (business sector, 1992=100)					
Output	111.4	140.5	159.8	165.8	3.8
Hours of all persons worked	109.6	121.2	118.0	120.4	2.0
Productivity (output per hour)	101.6	116.1	135.4	137.7	1.7
Employment and compensation					
Nonfarm private employment (millions)[3]	97.9	110.9	111.7	114.2	2.3
Unemployment rate (percent)	5.6	4.0	5.1	4.6	-9.8
Total compensation cost index (Dec.) (2005=100)	70.2	83.6	100.0	103.2	3.2
Wage and salary index (Dec) (2005=100)	72.2	86.7	100.0	103.2	3.2
Employee benefits cost index (Dec.) (2005=100)	65.7	76.7	100.0	103.1	3.1
Bank loans, interest rates, and yields					
Bank commercial and industrial loans (billions of dollars)	723.8	1,079.5	1,038.1	1,191.2	14.7
Prime rate (percent)	8.83	9.23	6.19	7.96	28.6
U.S. Treasury 10-year bond yields (percent)	6.57	6.03	4.29	4.80	11.9
Price indices (inflation measures)					
Consumer price index (urban) (1982-1984 = 100)	152.4	172.2	195.3	201.6	3.2
Producer price index (finished goods) (1982 = 100)	127.9	138.0	155.7	160.3	3.0
GDP implicit price deflator (2000 = 100)	92.1	100.0	112.7	116.0	2.9

Table A.3 Macroeconomic Indicators, 1995-2006 —continued

	1995	2000	2005	2006	Percent change 2005-2006
Equity markets					
S&P composite	541.7	1,427.2	1,207.2	1,310.5	8.6
NASDAQ	925.2	3,783.7	2,099.3	2,263.4	7.8

[1] *The Small Business Share of GDP, 1998-2004* by Katherine Kobe of Economic Consulting Services, LLC (Office of Advocacy funded study) estimates small businesses (fewer than 500 employees) created 50.7 percent of the total nonfarm private output in 2004.
[2] U.S. Census Bureau, Statistics of U.S. Business, showed that in 2002, small firms (fewer than 500 employees) accounted for 24.8 percent of manufacturing, 47.6 percent of retail, 41.2 percent of wholesale sales.
[3] U.S. Census Bureau, Statistics of U.S. Businesses, showed that in 2003, small firms accounted for 45.0 percent of annual payroll, and 50.7 percent of total nonfarm private employment.
[4] With inventory valuation adjustment and capital consumption adjustments.
Source: U.S. Small Business Administration, Office of Advocacy, from the Bureau of Economic Analysis, *Economic Indicators*, March 2000 and April 2007.

Table A.4 Number of Businesses by State, 2004-2006

State	Employer firms				Nonemployers (thousands)		Self-employment (thousands)	
	2005		2006		2004	2005	2005	2006
United States total	**5,995,200**	**e.**	**6,080,000**	**e.**	**19,524**	**20,392**	**15,780**	**16,143**
Alabama	88,274		86,813		267	283	178	194
Alaska	16,921		17,125		50	51	44	45
Arizona	118,193		128,786		335	358	301	280
Arkansas	62,696		66,021		178	187	160	163
California	1,075,066		1,146,269		2,509	2,609	2,225	2,377
Colorado	152,434		156,866		385	401	335	339
Connecticut	98,067		99,042		246	252	181	190
Delaware	25,741		26,068		49	52	37	37
District of Columbia	27,656		28,485		36	39	23	24
Florida	473,936		489,452		1,369	1,473	1,039	1,071
Georgia	206,800		212,713		611	657	455	479
Hawaii	30,466		31,152		84	88	72	80
Idaho	46,349		49,463		100	106	106	115
Illinois	290,866		295,322		802	835	621	598
Indiana	125,532		128,096		351	364	255	313
Iowa	70,566		71,394		189	193	208	209
Kansas	69,980		70,707		175	179	189	179
Kentucky	84,988		85,134		257	264	194	175
Louisiana	97,385		99,981		273	270	197	199
Maine	41,026		42,008		111	114	95	99
Maryland	139,483		141,726		380	400	272	278
Massachusetts	183,319		184,093		458	371	316	333
Michigan	214,316		219,140		611	639	487	480
Minnesota	133,288		134,083		361	373	326	333
Mississippi	54,666		55,178		156	164	139	144
Missouri	136,516		138,583		362	375	304	302
Montana	35,597		36,632		79	81	85	88
Nebraska	47,066		47,600		114	116	116	119
Nevada	54,641		57,512		152	164	120	110
New Hampshire	40,619		41,019		103	107	85	95
New Jersey	259,273		261,759		557	573	409	431
New Mexico	43,200		45,220		112	117	118	109
New York	486,228		491,433		1,410	1,443	902	908
North Carolina	186,684		192,761		551	583	441	418
North Dakota	19,594		19,962		43	44	56	51

Table A.4 Number of Businesses by State, 2004-2006 —continued

State	Employer firms		Nonemployers (thousands)		Self-employment (thousands)	
	2005	2006	2004	2005	2005	2006
Ohio	230,799	227,244	673	694	501	494
Oklahoma	77,591	79,895	248	256	230	217
Oregon	106,820	110,907	237	246	257	281
Pennsylvania	280,394	284,770	708	731	552	550
Rhode Island	33,679	33,855	67	69	50	53
South Carolina	95,844	98,732	247	260	196	209
South Dakota	24,349	24,797	54	56	64	71
Tennessee	111,607	113,862	405	423	301	317
Texas	412,520	424,308	1,582	1,686	1,142	1,149
Utah	62,915	67,169	163	175	151	152
Vermont	21,451	21,618	58	60	52	50
Virginia	177,476	181,039	448	470	372	406
Washington	194,963	198,195	370	387	373	388
West Virginia	36,684	36,797	88	90	61	62
Wisconsin	127,714	129,967	311	322	342	339
Wyoming	20,721	21,116	40	42	45	41

Notes: State totals do not add to the U.S. figure as firms can be in more than one state. U.S. 2005 and 2006 estimates are based on U.S. Census Bureau and Department of Labor, Employment and Training Administration data. Self-employment is based on monthly averages of primary occupation, incorporated and unincorporated status. The figures for self-employment cannot be added to the other figures.

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Department of Labor, Employment and Training Administration, and U.S. Census Bureau, Nonemployer Statistics and Current Population Survey, special tabulations.

Table A.5 Business Turnover by State, 2005-2006						
	Firm births		Firm terminations		Business bankruptcies	
	2005	2006	2005	2006	2005	2006
U.S. total	**653,100e.**	**649,700e.**	**543,700e.**	**564,900e.**	**39.201**	**19.695**
Alabama	10,575	10,096	10,168	11,128	331	219
Alaska	1,982	1,904	2,294	2,239	83	45
Arizona	21,339	21,555	18,249	52,375	525	261
Arkansas	7,591	9,551	7,021	7,289	426	276
California	121,482	115,684	151,944	149,212	4,236	2,098
Colorado	26,610	22,708	14,035	24,158	1,120	435
Connecticut	9,220	9,516	11,131	11,214	156	219
Delaware	3,299	3,153	3,355	3,295	218	244
District of Columbia	4,316	4,232	3,952	3,111	46	27
Florida	84,890	79,870	58,737	64,423	1,622	991
Georgia	29,804	31,677	29,315	29,787	2,232	1,148
Hawaii	3,763	3,813	3,794	3,789	81	25
Idaho	9,312	9,159	6,334	6,713	141	56
Illinois	30,445	30,230	32,846	33,426	1,042	669
Indiana	14,545	14,653	16,504	13,851	758	376
Iowa	6,004	5,877	6,802	7,248	455	208
Kansas	7,095	6,973	7,330	7,000	410	158
Kentucky	9,617	8,973	8,515	10,230	409	200
Louisiana	9,393	11,034	9,123	8,972	718	476
Maine	4,251	4,497	4,711	4,769	144	85
Maryland	22,083	21,535	21,769	20,745	760	333
Massachusetts	19,723	17,800	18,878	22,376	406	253
Michigan	24,642	23,508	26,971	21,268	1,071	753
Minnesota	12,555	13,739	15,302	14,403	1,721	381
Mississippi	6,071	6,862	6,823	7,898	200	187
Missouri	17,239	15,805	20,109	18,124	438	284
Montana	4,768	4,727	4,394	4,469	129	39
Nebraska	5,127	4,820	4,982	5,117	296	182
Nevada	11,299	10,743	8,485	8,423	333	178
New Hampshire	4,758	4,703	5,406	5,481	586	218
New Jersey	33,022	36,258	32,751	32,959	765	493
New Mexico	5,272	5,536	5,670	5,274	828	95
New York	62,045	61,718	62,667	61,190	2,112	1,201
North Carolina	25,906	26,729	22,867	23,165	612	403
North Dakota	1,893	1,821	2,512	2,181	95	32
Ohio	22,542	22,213	23,429	25,412	2,099	957
Oklahoma	8,609	9,962	7,231	7,829	944	236

Table A.5 Business Turnover by State, 2005-2006 —continued

	Firm births		Firm terminations		Business bankruptcies	
	2005	2006	2005	2006	2005	2006
Oregon	14,445	15,085	14,804	14,039	1,160	301
Pennsylvania	36,609	34,928	36,989	35,805	1,356	742
Rhode Island	3,677	3,739	4,164	4,572	136	48
South Carolina	12,341	12,373	10,681	11,661	176	82
South Dakota	2,102	2,003	2,354	2,449	196	47
Tennessee	17,484	17,207	17,135	16,395	574	397
Texas	55,858	58,943	55,039	54,479	3,590	2,081
Utah	11,536	13,379	11,871	11,190	449	148
Vermont	1,911	1,957	2,346	2,365	78	36
Virginia	25,061	23,686	21,359	20,972	476	283
Washington	30,353	32,726	40,944	36,331	786	401
West Virginia	3,493	3,823	4,869	4,854	282	114
Wisconsin	13,656	13,371	13,397	13,060	820	307
Wyoming	2,632	2,570	2,689	2,773	84	40

Notes: State birth and termination totals do not add to the U.S. figure as firms can be in more than one state. U.S. estimates are based on U.S. Census Bureau and Department of Labor, Employment and Training Administration data. Some terminations reflected in the state data may result in successor firms not listed as new firms. Data for total bankruptcies include territories.

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Department of Labor, Employment and Training Administration, U.S. Department of Commerce, Bureau of the Census, and Administrative Office of the U.S. Courts.

Table A.6 Private Firms, Establishments, Employment, Annual Payroll and Receipts, 1988-2004

Item	Year	Nonemployers	Employers	Employment size of firm <20	<500
Firms	2005	20,392,068	NA	NA	NA
	2004	19,523,741	5,885,784	5,255,844	5,868,737
	2003	18,649,114	5,767,127	5,150,316	5,750,201
	2002	17,646,062	5,697,759	5,090,331	5,680,914
	2001	16,979,498	5,657,774	5,036,845	5,640,407
	2000	16,529,955	5,652,544	5,035,029	5,635,391
	1999	16,152,604	5,607,743	5,007,808	5,591,003
	1998	15,708,727	5,579,177	4,988,367	5,562,799
	1997	15,439,609	5,541,918	4,958,641	5,525,839
	1996	NA	5,478,047	4,909,983	5,462,431
	1995	NA	5,369,068	4,807,533	5,353,624
	1994	NA	5,276,964	4,736,317	5,261,967
	1993	NA	5,193,642	4,661,601	5,179,013
	1992	14,325,000	5,095,356	4,572,994	5,081,234
	1991	NA	5,051,025	4,528,899	5,037,048
	1990	NA	5,073,795	4,535,575	5,059,772
	1989	NA	5,021,315	4,493,875	5,007,442
	1988	NA	4,954,645	4,444,473	4,941,821
Establishments	2005	20,392,068	7,499,702	NA	NA
	2004	19,523,741	7,387,724	5,308,118	6,331,242
	2003	18,649,114	7,254,745	5,203,488	6,222,091
	2002	17,646,062	7,200,770	5,147,526	6,172,809
	2001	16,979,498	7,095,302	5,093,660	6,079,993
	2000	16,529,955	7,070,048	5,093,832	6,080,050
	1999	16,152,604	7,008,444	5,068,096	6,048,129
	1998	15,708,727	6,941,822	5,048,528	6,030,325
	1997	15,439,609	6,894,869	5,026,425	6,017,638
	1996	NA	6,738,476	4,976,014	5,892,934
	1995	NA	6,612,721	4,876,327	5,798,936
	1994	NA	6,509,065	4,809,575	5,724,681
	1993	NA	6,401,233	4,737,778	5,654,835
	1992	14,325,000	6,319,300	4,653,464	5,571,896
	1991	NA	6,200,859	4,603,523	5,457,366
	1990	NA	6,175,559	4,602,362	5,447,605
	1989	NA	6,106,922	4,563,257	5,402,086
	1988	NA	6,016,367	4,516,707	5,343,026

Table A.6 Private Firms, Establishments, Employment, Annual Payroll and Receipts, 1988-2004 —continued

Item	Year	Nonemployers	Employers	Employment size of firm <20	Employment size of firm <500
Employment	2005	NA	116,317,003	NA	NA
	2004	NA	115,074,924	21,197,087	58,597,452
	2003	NA	113,398,043	20,830,352	57,447,570
	2002	NA	112,400,654	20,583,371	56,366,292
	2001	NA	115,061,184	20,602,635	57,383,449
	2000	NA	114,064,976	20,587,385	57,124,044
	1999	NA	110,705,661	20,388,287	55,729,092
	1998	NA	108,117,731	20,275,405	55,064,409
	1997	NA	105,299,123	20,118,816	54,545,370
	1996	NA	102,187,297	19,881,502	53,174,502
	1995	NA	100,314,946	19,569,861	52,652,510
	1994	NA	96,721,594	19,195,318	51,007,688
	1993	NA	94,773,913	19,070,191	50,316,063
	1992	NA	92,825,797	18,772,644	49,200,841
	1991	NA	92,307,559	18,712,812	49,002,613
	1990	NA	93,469,275	18,911,906	50,166,797
	1989	NA	91,626,094	18,626,776	49,353,860
	1988	NA	87,844,303	18,319,642	47,914,723
Annual payroll (thousands ofdollars)	2005	NA	4,482.722.481	NA	NA
	2004	NA	4,253,995,732	659,270,002	1,917,364,605
	2003	NA	4,040,888,841	631,221,418	1,818,493,862
	2002	NA	3,943,179,606	617,583,597	1,777,049,574
	2001	NA	3,989,086,323	603,848,633	1,767,546,642
	2000	NA	3,879,430,052	591,123,880	1,727,114,941
	1999	NA	3,554,692,909	561,547,424	1,601,129,388
	1998	NA	3,309,405,533	535,184,511	1,512,769,153
	1997	NA	3,047,907,469	503,130,254	1,416,200,011
	1996	NA	2,848,623,049	481,008,640	1,330,258,327
	1995	NA	2,665,921,824	454,009,065	1,252,135,244
	1994	NA	2,487,959,727	432,791,911	1,176,418,685
	1993	NA	2,363,208,106	415,254,636	1,116,443,440
	1992	NA	2,272,392,408	399,804,694	1,066,948,306
	1991	NA	2,145,015,851	381,544,608	1,013,014,303
	1990	NA	2,103,971,179	375,313,660	1,007,156,385
	1989	NA	1,989,941,554	357,259,587	954,137,110
	1988	NA	1,858,652,147	342,168,460	902,566,839

Table A.6 Private Firms, Establishments, Employment, Annual Payroll and Receipts, 1988-2004 —continued

Item	Year	Nonemployers	Employers	Employment size of firm	
				<20	<500
Receipts (thousands of dollars)	2002	770,032,328	22,062,528,196	3,126,610,830	8,558,731,333
	1997	586,315,756	18,242,632,687	2,786,839,570	7,468,211,700

NA = Not available.

Notes: A firm is an aggregation of all establishments (locations with payroll in any quarter) owned by a parent company. Employment is measured in March. This table does not show job growth, as firms can annually change size classes. See www.sba.gov/advo/research/data.html for more detail.

Source: U.S. Small Business Administration, Office of Advocacy, based on data provided by the U.S. Census Bureau, Statistics of U.S. Business and Nonemployer Statistics.

Table A.7 Employer Firms and Employment by Firm Size and State, 2004

State	Employers total	Employment size of firm <20	Employment size of firm <500	Employment total	Employment size of firm <20	Employment size of firm <500
United States	**5,885,784**	**5,255,844**	**5,868,737**	**115,074,924**	**21,197,087**	**58,597,452**
Alabama	79,426	67,556	77,272	1,629,141	299,149	826,227
Alaska	16,513	14,522	16,019	223,153	55,556	132,668
Arizona	101,196	86,404	98,448	2,044,134	343,926	1,001,948
Arkansas	53,235	45,917	51,728	1,007,512	191,400	499,766
California	696,301	612,222	690,854	13,264,918	2,449,848	6,965,332
Colorado	124,279	109,630	121,510	1,908,508	395,887	991,881
Connecticut	77,996	66,768	76,048	1,537,461	280,582	774,839
Delaware	20,979	17,020	19,581	391,682	65,393	180,034
District of Columbia	15,866	11,815	14,749	436,865	53,814	207,200
Florida	404,061	366,272	399,938	6,864,987	1,265,387	3,132,466
Georgia	172,434	149,244	168,738	3,452,451	583,545	1,611,421
Hawaii	25,815	21,897	25,016	473,500	93,583	268,923
Idaho	35,613	31,193	34,605	488,676	121,112	284,651
Illinois	259,734	224,273	255,562	5,217,160	902,794	2,643,598
Indiana	117,672	99,690	114,885	2,586,799	438,006	1,290,772
Iowa	65,784	56,479	64,170	1,241,864	233,392	660,379
Kansas	61,838	52,763	60,017	1,116,277	217,050	609,803
Kentucky	72,910	61,675	70,790	1,489,497	268,198	759,249
Louisiana	83,068	70,296	81,090	1,623,680	311,249	895,568
Maine	35,385	31,184	34,503	494,256	118,527	302,746
Maryland	112,268	96,047	109,720	2,151,474	399,674	1,146,309
Massachusetts	146,331	126,310	143,483	2,979,690	518,544	1,479,627
Michigan	193,690	167,622	190,718	3,895,914	715,685	2,030,850
Minnesota	123,203	106,241	120,778	2,393,126	419,520	1,244,357
Mississippi	48,426	41,279	46,920	928,313	177,368	472,998
Missouri	125,481	108,193	122,796	2,421,450	430,513	1,220,298
Montana	30,528	27,334	29,866	314,865	103,098	224,676
Nebraska	42,184	36,212	40,907	774,311	148,186	400,662
Nevada	46,482	38,738	44,546	1,022,011	149,996	453,052
New Hampshire	33,089	28,181	32,034	551,001	116,738	311,489
New Jersey	207,431	183,386	204,317	3,609,640	707,917	1,841,550
New Mexico	36,615	30,915	35,230	580,576	129,136	338,737
New York	441,188	395,675	437,074	7,433,686	1,452,934	3,870,083
North Carolina	170,016	147,200	166,775	3,365,633	609,352	1,648,665
North Dakota	17,572	14,978	16,973	265,663	60,729	167,708
Ohio	211,445	180,322	207,790	4,762,205	799,232	2,360,307

Table A.7 Employer Firms and Employment by Firm Size and State, 2004 —continued

State	Employers total	Employment size of firm <20	Employment size of firm <500	Employment total	Employment size of firm <20	Employment size of firm <500
Oklahoma	71,531	62,106	69,736	1,195,043	251,363	656,037
Oregon	88,513	77,544	86,543	1,355,542	306,077	771,433
Pennsylvania	241,215	208,222	237,400	5,107,044	889,478	2,569,151
Rhode Island	26,539	22,593	25,641	434,706	90,601	252,854
South Carolina	81,081	69,555	78,936	1,560,573	295,765	780,806
South Dakota	21,330	18,365	20,679	308,010	74,641	195,740
Tennessee	101,983	86,138	99,131	2,347,335	374,252	1,082,253
Texas	381,627	332,162	376,768	8,118,483	1,390,190	3,896,399
Utah	53,225	45,913	51,537	935,126	174,291	467,214
Vermont	19,503	17,002	18,891	256,132	68,547	162,782
Virginia	150,365	129,731	147,265	3,054,816	540,327	1,490,998
Washington	143,691	126,492	141,173	2,268,913	493,757	1,266,905
West Virginia	32,917	28,156	31,828	568,619	121,031	313,559
Wisconsin	117,647	99,995	115,330	2,435,143	440,790	1,311,515
Wyoming	17,007	14,816	16,444	187,360	58,957	128,967

Notes: For state data, a firm is as an aggregation of all establishments (locations with payroll in any quarter) owned by a parent company within a state (start-ups after March, closures before March, and seasonal firms could have zero employment). See www.sba.gov/advo/research/data.html for more detail.

Source: U.S. Small Business Administration, Office of Advocacy, based on data provided by the U.S. Census Bureau.

Table A.8 Firms and Employment by Firm Size and Industry, 2004				
			Employment size of firm	
Industry	Nonemployers	Employers	<20	<500
Firms				
Total	19,523,741	5,885,784	5,255,844	5,868,737
Agriculture, forestry, fishing, and hunting	230,604	24,873	23,134	24,782
Mining	91,008	18,605	15,631	18,290
Utilities	15,679	6,695	5,343	6,501
Construction	2,391,632	751,098	687,838	750,120
Manufacturing	302,837	293,461	217,531	289,425
Wholesale trade	384,333	337,642	289,212	334,655
Retail trade	1,892,827	734,984	662,950	732,712
Transportation and warehousing	915,819	164,803	144,065	162,680
Information	283,266	75,271	63,755	74,125
Finance and insurance	717,539	251,965	230,223	250,251
Real estate and rental and leasing	2,218,340	282,765	268,119	281,557
Professional, scientific, and technical services	2,725,096	734,912	686,866	732,034
Management of companies and enterprises	—	26,626	6,026	19,827
Administrative, support, waste management and remediation services	1,337,222	310,261	271,012	306,941
Educational services	409,804	71,232	54,152	70,127
Health care and social assistance	1,608,718	588,187	512,082	584,480
Arts, entertainment, and recreation	923,144	111,309	95,502	110,686
Accommodation and food services	275,475	453,433	362,926	451,683
Other services (except public administration)	2,800,398	671,348	624,233	669,983
Unclassified	—	41,157	40,986	41,154
Employment				
Total	—	115,074,924	21,197,087	58,597,452
Agriculture, forestry, fishing, and hunting	—	182,121	81,763	—
Mining	—	470,280	64,750	211,124
Utilities	—	634,734	21,396	107,513
Construction	—	6,647,641	2,555,155	5,745,598
Manufacturing	—	13,821,976	1,212,677	6,080,495
Wholesale trade	—	5,907,051	1,252,876	3,637,296
Retail trade	—	15,351,431	2,880,638	6,471,679
Transportation and warehousing	—	4,098,870	522,250	1,570,948
Information	—	3,472,427	251,638	908,899
Finance and insurance	—	6,481,304	759,912	2,107,749

Table A.8 Firms and Employment by Firm Size and Industry, 2004 —continued				
			Employment size of firm	
Industry	Nonemployers	Employers	<20	<500
Real estate and rental and leasing	—	2,086,085	749,480	1,442,094
Professional, scientific, and technical services	—	7,569,981	2,202,024	4,660,511
Management of companies and enterprises	—	2,824,787	16,437	342,554
Admin., support, waste mngt. and remediation srv.	—	8,708,052	983,272	3,582,942
Educational services	—	2,893,346	247,476	1,329,651
Health care and social assistance	—	15,814,812	2,492,459	7,665,652
Arts, entertainment, and recreation	—	1,889,044	346,327	1,279,224
Accommodation and food services	—	10,749,811	1,951,458	6,567,667
Other services (except public administration)	—	5,416,193	2,555,108	4,672,543
Unclassified	—	54,978	49,991	—

Notes: Employment is measured in March; thus, some firms (start-ups after March, closures before March, and seasonal firms) will have zero employment. Firms are an aggregation of all establishments owned by a parent company within an industry. See www.sba.gov/advo/research/data.html for more detail.

Source: U.S. Small Business Administration, Office of Advocacy, based on data provided by the U.S. Census Bureau.

Table A.9 Employer Firm Births and Deaths by Employment Size of Firm, 1990-2004					
			Beginning year employment size of firm		
Period	Type of change	Total	<20	<500	500+
Firms					
2003-2004	Firm births	628,917	601,927	628,655	262
	Firm deaths	541,047	515,031	540,746	301
	Net change	87,870	86,896	87,909	-39
2002-2003	Firm births	612,296	585,552	611,976	320
	Firm deaths	540,658	514,565	540,328	330
	Net change	71,638	70,987	71,648	-10
2001-2002	Firm births	569,750	541,516	568,280	1,470
	Firm deaths	586,890	557,133	586,535	355
	Net change	-17,140	-15,617	-18,255	1,115
2000-2001	Firm births	585,140	558,037	584,837	303
	Firm deaths	553,291	523,960	552,839	452
	Net change	31,849	34,077	31,998	-149
1999-2000	Firm births	574,300	548,030	574,023	277
	Firm deaths	542,831	514,242	542,374	457
	Net change	31,469	33,788	31,649	-180
1998-1999	Firm births	579,609	554,288	579,287	322
	Firm deaths	544,487	514,293	544,040	447
	Net change	35,122	39,995	35,247	-125
1997-1998	Firm births	589,982	564,804	589,706	276
	Firm deaths	540,601	511,567	540,112	489
	Net change	49,381	53,237	49,594	-213
1996-1997	Firm births	590,644	564,197	590,335	309
	Firm deaths	530,003	500,014	529,481	522
	Net change	60,641	64,183	60,854	-213
1995-1996	Firm births	597,792	572,442	597,503	289
	Firm deaths	512,402	485,509	512,024	378
	Net change	85,390	86,933	85,479	-89
1994-1995	Firm births	594,369	568,896	594,119	250
	Firm deaths	497,246	472,441	496,874	372
	Net change	97,123	96,455	97,245	-122
1993-1994	Firm births	570,587	546,437	570,337	250
	Firm deaths	503,563	476,667	503,125	438
	Net change	67,024	69,770	67,212	-188
1992-1993	Firm births	564,504	539,601	564,093	411
	Firm deaths	492,651	466,550	492,266	385
	Net change	71,853	73,051	71,827	26

Table A.9 Employer Firm Births and Deaths by Employment Size of Firm, 1990-2004 —continued

Period	Type of change	Total	Beginning year employment size of firm		
			<20	<500	500+
1991-1992	Firm births	544,596	519,014	544,278	318
	Firm deaths	521,606	492,746	521,176	430
	Net change	22,990	26,268	23,102	-112
1990-1991	Firm births	541,141	515,870	540,889	252
	Firm deaths	546,518	516,964	546,149	369
	Net change	-5,377	-1,094	-5,260	-117

Notes: The data represent activity from March of the beginning year to March of the ending year. Establishments with no employment in the first quarter of the beginning year were excluded. Firm births are classified by their first quarter employment size. New firms represent new original establishments and deaths represent closed original establishments. See www.sba.gov/advo/research/data.html for more detail.

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Bureau of the Census.

Table A.10 Job Generation and Losses by Employment Size of Firm, 1990-2004

Period	Type of change	Total	Beginning year employment size of firm <20	<500	500+
Employment					
2003-2004	Firm births	3,574,679	1,889,381	3,240,945	333,734
	Firm deaths	3,220,504	1,614,965	2,867,719	352,785
	Existing firm expansions	14,377,177	3,359,333	7,121,196	7,255,981
	Existing firm contractions	13,055,467	2,009,138	5,604,304	7,451,163
	Net change	1,675,885	1,624,611	1,890,118	-214,233
2002-2003	Firm births	3,667,154	1,855,516	3,174,129	493,025
	Firm deaths	3,324,483	1,608,299	2,879,797	444,686
	Existing firm expansions	14,677,406	3,438,778	7,641,202	7,036,204
	Existing firm contractions	14,024,418	2,112,533	5,945,208	8,079,210
	Net change	995,659	1,573,462	1,990,326	-994,667
2001-2002	Firm births	3,369,930	1,748,097	3,033,734	336,196
	Firm deaths	3,660,161	1,755,255	3,256,851	403,310
	Existing firm expansions	15,385,726	3,149,876	7,587,961	7,797,765
	Existing firm contractions	17,756,053	2,289,644	7,794,376	9,961,677
	Net change	-2,660,558	853,074	-429,532	-2,231,026
2000-2001	Firm births	3,418,369	1,821,298	3,108,501	309,868
	Firm deaths	3,261,621	1,700,677	3,049,714	211,907
	Existing firm expansions	14,939,658	3,065,106	7,033,084	7,906,574
	Existing firm contractions	14,096,436	2,074,544	5,940,996	8,155,440
	Net change	999,970	1,111,183	1,150,875	-150,905
1999-2000	Firm births	3,228,804	1,792,946	3,031,079	197,725
	Firm deaths	3,176,609	1,653,694	2,946,120	230,489
	Existing firm expansions	15,857,582	3,378,838	7,744,430	8,113,152
	Existing firm contractions	12,550,358	1,924,624	5,323,677	7,226,681
	Net change	3,359,419	1,593,466	2,505,712	853,707
1998-1999	Firm births	3,247,335	1,763,823	3,011,400	235,935
	Firm deaths	3,267,136	1,676,282	3,052,630	214,506
	Existing firm expansions	14,843,903	3,245,218	7,266,399	7,577,504
	Existing firm contractions	12,236,364	1,969,501	5,482,142	6,754,222
	Net change	2,587,738	1,363,258	1,743,027	844,711

Period	Type of change	Total	Beginning year employment size of firm <20	<500	500+
1997-1998	Firm births	3,205,451	1,812,103	3,002,401	203,050
	Firm deaths	3,233,412	1,661,544	2,991,722	241,690
	Existing firm expansions	14,885,560	3,238,047	7,471,622	7,413,938
	Existing firm contractions	12,044,422	2,002,313	5,747,725	6,296,697
	Net change	2,813,177	1,386,293	1,734,576	1,078,601
1996-1997	Firm births	3,227,556	1,813,539	3,029,666	197,890
	Firm deaths	3,274,604	1,620,797	2,960,814	313,790
	Existing firm expansions	16,243,424	3,400,037	8,628,839	7,614,585
	Existing firm contractions	13,092,093	2,035,083	6,343,489	6,748,604
	Net change	3,104,283	1,557,696	2,354,202	750,081
1995-1996	Firm births	3,255,676	1,844,516	3,055,596	200,080
	Firm deaths	3,099,589	1,559,598	2,808,493	291,096
	Existing firm expansions	12,937,389	3,122,066	6,725,135	6,212,254
	Existing firm contractions	11,226,231	1,971,531	5,512,726	5,713,505
	Net change	1,867,245	1,435,453	1,459,512	407,733
1994-1995	Firm births	3,322,001	1,836,153	3,049,456	272,545
	Firm deaths	2,822,627	1,516,552	2,633,587	189,040
	Existing firm expansions	13,034,649	3,235,940	7,197,705	5,836,944
	Existing firm contractions	9,942,456	1,877,758	5,000,269	4,942,187
	Net change	3,591,567	1,677,783	2,613,305	978,262
1993-1994	Firm births	3,105,753	1,760,322	2,889,507	216,246
	Firm deaths	3,077,307	1,549,072	2,800,933	276,374
	Existing firm expansions	12,366,436	3,139,825	6,905,182	5,461,254
	Existing firm contractions	10,450,422	2,039,535	5,400,406	5,050,016
	Net change	1,944,460	1,311,540	1,593,350	351,110
1992-1993	Firm births	3,438,106	1,750,662	3,053,765	384,341
	Firm deaths	2,906,260	1,515,896	2,697,656	208,604
	Existing firm expansions	12,157,943	3,206,101	6,817,835	5,340,108
	Existing firm contractions	10,741,536	1,965,039	5,386,708	5,354,828
	Net change	1,948,253	1,475,828	1,787,236	161,017

Table A.10 Job Generation and Losses by Employment Size of Firm, 1990-2004 —continued

Table A.10 Job Generation and Losses by Employment Size of Firm, 1990-2004 —continued

Period	Type of change	Total	Beginning year employment size of firm		
			<20	<500	500+
1991-1992	Firm births	3,200,969	1,703,491	2,863,799	337,170
	Firm deaths	3,126,463	1,602,579	2,894,127	232,336
	Existing firm expansions	12,894,780	3,197,959	7,510,392	5,384,388
	Existing firm contractions	12,446,175	2,156,402	6,635,366	5,810,809
	Net change	523,111	1,142,469	844,698	-321,587
1990-1991	Firm births	3,105,363	1,712,856	2,907,351	198,012
	Firm deaths	3,208,099	1,723,159	3,044,470	163,629
	Existing firm expansions	11,174,786	2,855,498	6,323,224	4,851,562
	Existing firm contractions	12,233,766	2,294,270	6,893,623	5,340,143
	Net change	-1,161,716	550,925	-707,518	-454,198

Notes: The data represent activity from March of the beginning year to March of the ending year. Establishments with no employment in the first quarter of the beginning year were excluded. Firm births are classified by their first quarter employment size. Percentages are not calculated when changes include negative numbers. New firms represent new original establishments and deaths represent closed original establishments. See www.sba.gov/advo/research/data.html for more detail.

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Bureau of the Census.

Table A.11 Opening and Closing Establishments, 1992-2006 (in thousands, seasonally adjusted)

		Opening establishments		Closing establishments		Net	
Year	Quarter	Number	Employment	Number	Employment	Number	Employment
2006	4	381	1,479	345	1,333	36	146
	3	341	1,379	349	1,335	-8	44
	2	360	1,475	341	1,358	19	117
	1	353	1,351	341	1,236	12	115
2005	4	375	1,525	329	1,379	46	146
	3	375	1,632	339	1,512	36	120
	2	371	1,621	340	1,485	31	136
	1	345	1,464	347	1,458	-2	6
2004	4	379	1,716	320	1,485	59	231
	3	354	1,666	345	1,645	9	21
	2	343	1,565	330	1,537	13	28
	1	349	1,514	328	1,439	21	75
2003	4	348	1,583	322	1,486	26	97
	3	328	1,499	318	1,431	10	68
	2	331	1,527	328	1,564	3	-37
	1	332	1,540	334	1,555	-2	-15
2002	4	349	1,643	329	1,610	20	33
	3	341	1,680	325	1,629	16	51
	2	348	1,804	334	1,719	14	85
	1	338	1,804	331	1,729	7	75
2001	4	352	1,838	335	1,769	17	69
	3	335	1,759	367	1,955	-32	-196
	2	339	1,815	333	1,876	6	-61
	1	343	1,787	337	1,900	6	-113
2000	4	353	1,828	336	1,772	17	56
	3	355	1,890	348	1,859	7	31
	2	354	1,789	325	1,714	29	75
	1	357	1,918	328	1,727	29	191
1999	4	365	2,032	326	1,775	39	257
	3	346	1,946	339	1,872	7	74
	2	338	2,012	337	1,812	1	200
	1	335	2,011	318	1,898	17	113
1998	4	320	1,798	318	1,757	2	41
	3	336	1,965	316	1,719	20	246
	2	353	2,153	296	1,838	57	315
	1	347	2,155	323	1,934	24	221

Table A.11 Opening and Closing Establishments, 1992-2006 (in thousands, seasonally adjusted) —continued

		Opening establishments		Closing establishments		Net	
Year	Quarter	Number	Employment	Number	Employment	Number	Employment
1997	4	335	2,004	328	1,961	7	43
	3	328	1,913	308	1,758	20	155
	2	321	1,756	304	1,579	17	177
	1	331	1,844	299	1,593	32	251
1996	4	327	1,869	300	1,528	27	341
	3	328	1,863	293	1,559	35	304
	2	318	1,778	299	1,544	19	234
	1	321	1,753	298	1,526	23	227
1995	4	311	1,724	294	1,536	17	188
	3	306	1,679	291	1,519	15	160
	2	306	1,697	286	1,473	20	224
	1	306	1,653	274	1,376	32	277
1994	4	295	1,632	284	1,476	11	156
	3	314	1,745	268	1,304	46	441
	2	309	1,747	285	1,491	24	256
	1	290	1,593	278	1,448	12	145
1993	4	286	1,596	263	1,375	23	221
	3	302	1,642	255	1,333	47	309
	2	293	1,536	272	1,408	21	128
	1	308	1,899	273	1,642	35	257
1992	4	289	1,636	271	1,398	18	238
	3	295	1,745	273	1,571	22	174

Note: Establishments could be new ventures or new affiliates of existing ventures.

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Bureau of Labor Statistics, Business Employment Dynamics.

Table A.12 Quarterly Net Job Change by Firm Size, 1992-2006 (thousands, seasonally adjusted)

			Firm size			Percent of total	
Year	Quarter	Total	1-19	20-499	500+	1-19	<500
2006	4	516	69	102	345	13	33
	3	19	-56	45	17	NA	NA
	2	466	51	279	135	11	71
	1	784	161	420	124	23	82
2005	4	551	120	98	349	21	38
	3	628	158	185	318	24	52
	2	574	136	322	76	25	86
	1	325	30	151	117	10	61
2004	4	869	216	213	417	26	51
	3	191	44	145	16	21	92
	2	594	82	274	209	15	63
	1	435	141	244	34	34	92
2003	4	344	95	49	183	29	44
	3	72	74	24	23	61	81
	2	-142	79	4	-274	NA	NA
	1	-404	-62	-140	-153	17	57
2002	4	-175	28	-136	-122	NA	47
	3	-211	49	-120	-93	NA	43
	2	-80	51	10	-196	NA	NA
	1	-1	57	-66	76	NA	NA
2001	4	-871	-19	-407	-546	2	44
	3	-1,380	-191	-493	-701	14	49
	2	-771	-41	-319	-475	5	43
	1	-101	42	-126	119	NA	NA
2000	4	336	28	70	176	10	36
	3	146	13	122	67	6	67
	2	541	43	172	271	9	44
	1	818	185	379	308	21	65
1999	4	1,105	264	438	294	27	70
	3	548	80	244	294	13	52
	2	569	49	235	242	9	54
	1	380	122	73	335	23	37
1998	4	759	88	345	226	13	66
	3	659	60	217	465	8	37
	2	666	243	188	210	38	67
	1	747	112	258	530	12	41

Table A.12 Quarterly Net Job Change by Firm Size, 1992-2006 (thousands, seasonally adjusted) —continued

			Firm size			Percent of total	
Year	Quarter	Total	1-19	20-499	500+	1-19	<500
1997	4	702	55	264	287	9	53
	3	854	131	377	419	14	55
	2	594	91	228	292	15	52
	1	799	224	326	288	27	66
1996	4	861	128	357	316	16	61
	3	632	188	280	216	27	68
	2	642	124	177	344	19	47
	1	460	129	204	177	25	65
1995	4	407	73	247	50	20	86
	3	771	136	340	385	16	55
	2	402	91	154	154	23	61
	1	746	179	329	200	25	72
1994	4	507	46	281	166	9	66
	3	1,175	358	515	373	29	70
	2	1,021	166	402	435	17	57
	1	517	95	263	112	20	76
1993	4	641	154	324	148	25	76
	3	874	294	417	230	31	76
	2	786	180	307	268	24	65
	1	313	61	162	34	24	87
1992	4	216	74	145	33	29	87
	3	455	159	219	154	30	71

NA = not available

Notes: Size based on dynamic sizing (see www.bls.gov/news.release/cewfs.tn.htm). Firm sizes may not add to the total as some firms do not have firm size identifiers. Percentages are based on adding the size categories, not the listed total. Better firm size catagories and the actual job gains and loss figures are available directly from the data source.

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Bureau of Labor Statistics, Business Employment Dynamics.

Table A.13 Characteristics of Self-Employed Individuals, 1995-2005 (thousands except as noted)							
				2005			1995 - 2005
Characteristic	1995	2000	2004	Number	Percent	Rate	Percent change
Total	13,921.9	13,832.4	15,614.6	15,739.0	100.0	10.1	13.1
Sex							
Female	4,614.7	4,819.6	5,243.3	5,226.6	33.2	7.2	13.3
Male	9,307.2	9,012.8	10,371.3	10,512.4	66.8	12.7	12.9
Race							
Asian / American Indian	547.5	759.8	801.8	879.1	5.6	10.6	60.6
Black	612.1	679.3	823.9	774.8	4.9	4.5	26.6
White	12,762.4	12,393.3	13,790.3	13,874.4	88.2	10.9	8.7
Multiple	NA	NA	198.6	210.8	1.3	9.3	NA
Origin or Descent							
Hispanic	698.9	775.6	1,308.8	1,368.1	8.7	6.7	95.7
Age							
<25	501.0	375.8	504.3	516.5	3.3	2.2	3.1
25-34	2,181.8	1,824.3	2,107.3	2,114.1	13.4	6.4	-3.1
35-44	4,132.6	3,941.1	4,087.7	3,781.2	24.0	10.4	-8.5
45-54	3,576.0	3,995.0	4,302.0	4,624.6	29.4	13.1	29.3
55-64	2,214.3	2,274.6	3,108.4	3,245.5	20.6	15.5	46.6
65+	1,316.2	1,421.6	1,504.9	1,457.1	9.3	23.1	10.7
Educational level							
High school degree	6,055.0	5,485.1	6,010.9	5,712.9	36.3	8.8	-5.6
Some college	3,575.2	3,822.5	4,144.0	4,322.9	27.5	9.5	20.9
Bachelors	2,643.4	2,838.9	3,415.7	3,577.4	22.7	12.1	35.3
Masters or above	1,648.3	1,685.9	2,043.9	2,125.8	13.5	14.0	29.0
Veteran status	2,492.5	2,029.3	1,944.4	1,935.9	12.3	15.1	-22.3
Disability	628.6	592.5	652.7	754.3	4.8	16.1	20.0
Native born	12,411.0	12,078.8	13,390.8	13,329.8	84.7	10.2	7.4
Location							
Central city	2,650.1	2,506.2	3,324.1	3,762.5	23.9	9.2	42.0
Suburban	5,988.6	6,095.6	6,909.0	6,752.8	42.9	10.0	12.8
Rural	3,382.9	3,321.5	3,090.2	2,926.5	18.6	12.4	-13.5
Not identified	1,900.3	1,909.1	2,291.3	2,297.2	14.6	9.8	20.9

NA = not available

Notes: Self-employment (incorporated and unincorporated) was the primary occupation during the year. Self-employment figures presented here differ from the published monthly annual averages. Asian / American Indian = Asian, Pacific, Hawaiian, American Indian and Aleut Eskimo. Disability consists of disabilities or health problems that restrict or prevent the amount or kind of work. The rate is the self-employment divided by the number of individuals that had any job during the year.

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the U.S. Department of Commerce, Bureau of the Census, March Supplement to the Current Population Survey.

Table A.14 Bank Lending Information by Size of Firm, 1991-2006 (Change in percent of senior loan officer responses on bank lending practices)

		Tightening loan standards		Stronger demand for loans	
Year	Quarter	Large and medium	Small	Large and medium	Small
2006	4	0	-2	-4	-13
	3	-9	-2	-2	0
	2	-12	-7	4	4
	1	-11	-7	16	5
2005	4	-9	-5	14	9
	3	-17	-11	41	35
	2	-24	-24	37	37
	1	-24	-13	46	30
2004	4	-21	-18	26	26
	3	-20	-4	31	39
	2	-23	-20	29	38
	1	-18	-11	11	22
2003	4	0	-2	-12	-4
	3	4	4	-23	-12
	2	9	13	-39	-22
	1	22	14	-32	-21
2002	4	20	18	-53	-48
	3	21	6	-45	-36
	2	25	15	-36	-29
	1	45	42	-55	-45
2001	4	51	40	-70	-50
	3	40	32	-53	-42
	2	51	36	-40	-35
	1	60	45	-50	-30
2000	4	44	27	-23	-13
	3	34	24	-5	-4
	2	25	21	-9	5
	1	11	9	9	-2
1999	4	9	2	-2	-4
	3	5	2	0	0
	2	10	8	0	10
	1	7	4	20	11
1998	4	36	15	28	8
	3	0	-5	-9	0
	2	-7	-2	29	21
	1	2	2	26	15

Table A.14 Bank Lending Information by Size of Firm, 1991-2006 (Change in percent of senior loan officer responses on bank lending practices) —continued

		Tightening loan standards		Stronger demand for loans	
Year	Quarter	Large and medium	Small	Large and medium	Small
1997	4	-7	-4	19	19
	3	-6	-2	13	20
	2	-7	-4	5	11
	1	-5	-5	5	15
1996	4	-8	-12	1	4
	3	-4	-2	12	18
	2	-1	2	10	24
	1	7	4	-3	14
1995	4	-3	-2	3	7
	3	-6	-2	4	25
	2	-6	-7	29	17
	1	-7	-5	35	18
1994	4	-17	-18	31	32
	3	-7	-7	31	19
	2	-12	-9	38	38
	1	-13	-12	26	26
1993	4	-18	-9	9	17
	3	-19	-12	18	14
	2	-8	-2	0	12
	1	3	-2	20	32
1992	4	4	-5	6	-2
	3	-2	-2	-9	7
	2	1	-7	6	25
	1	5	0	-27	-12
1991	4	9	5	-30	-25
	3	12	9	NA	NA
	2	16	7	NA	NA
	1	36	32	NA	NA

Notes: NA = not available. Figures should be used with caution because the sample size of the survey is relatively small—about 80 respondents—but they do represent a sizeable portion of the market. Small firms are defined as having sales of less than $50 million. The survey asks the following question to gauge lending standards, “Over the past three months, how have your bank’s credit standards for approving applications for C&I loans or credit lines—other than those to be used to finance mergers and acquisitions—to large and middle-market firms and to small firms changed?” The survey asks the following question to gauge lending demand, “Apart from normal seasonal variation, how has demand for C&I loans changed over the past three months?”

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the Federal Reserve Board.

APPENDIX B

The Regulatory Flexibility Act and Executive Order 13272

The following text of the Regulatory Flexibility Act of 1980, as amended, is taken from Title 5 of the United States Code, Sections 601–612. The Regulatory Flexibility Act was originally passed in 1980 (P.L. 96-354). The act was amended by the Small Business Regulatory Enforcement Fairness Act of 1996 (P.L. 104-121).

The Regulatory Flexibility Act of 1980 as amended

Congressional Findings and Declaration of Purpose

(a) The Congress finds and declares that —

(1) when adopting regulations to protect the health, safety and economic welfare of the Nation, Federal agencies should seek to achieve statutory goals as effectively and efficiently as possible without imposing unnecessary burdens on the public;

(2) laws and regulations designed for application to large scale entities have been applied uniformly to small businesses, small organizations, and small governmental jurisdictions even though the problems that gave rise to government action may not have been caused by those smaller entities;

(3) uniform Federal regulatory and reporting requirements have in numerous instances imposed unnecessary and disproportionately burdensome demands including legal, accounting and consulting costs upon small businesses, small organizations, and small governmental jurisdictions with limited resources;

(4) the failure to recognize differences in the scale and resources of regulated entities has in numerous instances adversely affected competition in the marketplace, discouraged innovation and restricted improvements in productivity;

(5) unnecessary regulations create entry barriers in many industries and discourage potential entrepreneurs from introducing beneficial products and processes;

(6) the practice of treating all regulated businesses, organizations, and governmental jurisdictions as equivalent may lead to inefficient use of regulatory agency resources, enforcement problems and, in some cases, to actions inconsistent with the legislative intent of health, safety, environmental and economic welfare legislation;

(7) alternative regulatory approaches which do not conflict with the stated objectives of applicable statutes may be available which minimize the significant economic impact of rules on small businesses, small organizations, and small governmental jurisdictions;

(8) the process by which Federal regulations are developed and adopted should be reformed to require agencies to solicit the ideas and comments of small businesses, small organizations, and small governmental jurisdictions to examine the impact of proposed and existing rules on such entities, and to review the continued need for existing rules.

(b) It is the purpose of this Act [enacting this chapter and provisions set out as notes under this section] to establish as a principle of regulatory issuance that agencies shall endeavor, consistent with the objectives of the rule and of applicable statutes, to fit regulatory and informational requirements to the scale of the businesses, organizations, and governmental jurisdictions subject to regulation. To achieve this principle, agencies are required to solicit and consider flexible regulatory proposals and to explain the rationale for their actions to assure that such proposals are given serious consideration.

Regulatory Flexibility Act

§ 601 Definitions

For purposes of this chapter —

(1) the term "agency" means an agency as defined in section 551(1) of this title;

(2) the term "rule" means any rule for which the agency publishes a general notice of proposed rulemaking pursuant to section 553(b) of this title, or any other law, including any rule of general applicability governing Federal grants to State and local governments for which the agency provides an opportunity for notice and public comment, except that the term "rule" does not include a rule of particular applicability relating to rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services, or allowances therefor or to valuations, costs or accounting, or practices relating to such rates, wages, structures, prices, appliances, services, or allowances;

(3) the term "small business" has the same meaning as the term "small business concern" under section 3 of the Small Business Act, unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register;

(4) the term "small organization" means any not-for-profit enterprise which is independently owned and operated and is not dominant in its field, unless an agency establishes, after opportunity for public comment, one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register;

(5) the term "small governmental jurisdiction" means governments of cities, counties, towns, townships, villages, school districts, or special districts, with a population of less than fifty thousand, unless an agency establishes, after opportunity for public com-

ment, one or more definitions of such term which are appropriate to the activities of the agency and which are based on such factors as location in rural or sparsely populated areas or limited revenues due to the population of such jurisdiction, and publishes such definition(s) in the Federal Register;

(6) the term "small entity" shall have the same meaning as the terms "small business," "small organization" and "small governmental jurisdiction" defined in paragraphs (3), (4) and (5) of this section; and

(7) the term "collection of information" —

(A) means the obtaining, causing to be obtained, soliciting, or requiring the disclosure to third parties or the public, of facts or opinions by or for an agency, regardless of form or format, calling for either —

(i) answers to identical questions posed to, or identical reporting or recordkeeping requirements imposed on, 10 or more persons, other than agencies, instrumentalities, or employees of the United States; or

(ii) answers to questions posed to agencies, instrumentalities, or employees of the United States which are to be used for general statistical purposes; and

(B) shall not include a collection of information described under section 3518(c)(1) of title 44, United States Code.

(8) Recordkeeping requirement — The term "recordkeeping requirement" means a requirement imposed by an agency on persons to maintain specified records.

§ 602. Regulatory agenda

(a) During the months of October and April of each year, each agency shall publish in the Federal Register a regulatory flexibility agenda which shall contain —

(1) a brief description of the subject area of any rule which the agency expects to propose or promulgate which is likely to have

a significant economic impact on a substantial number of small entities;

(2) a summary of the nature of any such rule under consideration for each subject area listed in the agenda pursuant to paragraph (1), the objectives and legal basis for the issuance of the rule, and an approximate schedule for completing action on any rule for which the agency has issued a general notice of proposed rulemaking, and

(3) the name and telephone number of an agency official knowledgeable concerning the items listed in paragraph (1).

(b) Each regulatory flexibility agenda shall be transmitted to the Chief Counsel for Advocacy of the Small Business Administration for comment, if any.

(c) Each agency shall endeavor to provide notice of each regulatory flexibility agenda to small entities or their representatives through direct notification or publication of the agenda in publications likely to be obtained by such small entities and shall invite comments upon each subject area on the agenda.

(d) Nothing in this section precludes an agency from considering or acting on any matter not included in a regulatory flexibility agenda, or requires an agency to consider or act on any matter listed in such agenda.

§ 603. Initial regulatory flexibility analysis

(a) Whenever an agency is required by section 553 of this title, or any other law, to publish general notice of proposed rulemaking for any proposed rule, or publishes a notice of proposed rulemaking for an interpretative rule involving the internal revenue laws of the United States, the agency shall prepare and make available for public comment an initial regulatory flexibility analysis. Such analysis shall describe the impact of the proposed rule on small entities. The initial regulatory flexibility analysis or a summary shall be published in the Federal Register at the time of the publication of general notice of proposed rulemaking for the rule. The agency shall transmit a copy of the initial regulatory flexibility analysis to the Chief Counsel for Advocacy of the Small Business Administration. In the case of an interpretative rule involving the internal revenue laws of the United States, this chapter applies to interpretative rules published in the Federal Register for codification in the Code of Federal Regulations, but only to the extent that such interpretative rules impose on small entities a collection of information requirement.

(b) Each initial regulatory flexibility analysis required under this section shall contain —

(1) a description of the reasons why action by the agency is being considered;

(2) a succinct statement of the objectives of, and legal basis for, the proposed rule;

(3) a description of and, where feasible, an estimate of the number of small entities to which the proposed rule will apply;

(4) a description of the projected reporting, recordkeeping and other compliance requirements of the proposed rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record;

(5) an identification, to the extent practicable, of all relevant Federal rules which may duplicate, overlap or conflict with the proposed rule.

(c) Each initial regulatory flexibility analysis shall also contain a description of any significant alternatives to the proposed rule which accomplish the stated objectives of applicable statutes and which minimize any significant economic impact of the proposed rule on small entities. Consistent with the stated objectives of applicable statutes, the analysis shall discuss significant alternatives such as —

(1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities;

(2) the clarification, consolidation, or simplification of compliance and reporting requirements under the rule for such small entities;

(3) the use of performance rather than design standards; and

(4) an exemption from coverage of the rule, or any part thereof, for such small entities.

§ 604. Final regulatory flexibility analysis

(a) When an agency promulgates a final rule under section 553 of this title, after being required by that section or any other law to publish a general notice of proposed rulemaking, or promulgates a final interpretative rule involving the internal revenue laws of the United States as described in section 603(a), the agency shall prepare a final regulatory flexibility analysis. Each final regulatory flexibility analysis shall contain —

(1) a succinct statement of the need for, and objectives of, the rule;

(2) a summary of the significant issues raised by the public comments in response to the initial regulatory flexibility analysis, a summary of the assessment of the agency of such issues, and a statement of any changes made in the proposed rule as a result of such comments;

(3) a description of and an estimate of the number of small entities to which the rule will apply or an explanation of why no such estimate is available;

(4) a description of the projected reporting, recordkeeping and other compliance requirements of the rule, including an estimate of the classes of small entities which will be subject to the requirement and the type of professional skills necessary for preparation of the report or record; and

(5) a description of the steps the agency has taken to minimize the significant economic impact on small entities consistent with the stated objectives of applicable statutes, including a statement of the factual, policy, and legal reasons for selecting the alternative adopted in the final rule and why each one of the other significant alternatives to the rule considered by the agency which affect the impact on small entities was rejected.

(b) The agency shall make copies of the final regulatory flexibility analysis available to members of the public and shall publish in the Federal Register such analysis or a summary thereof..

§ 605. Avoidance of duplicative or unnecessary analyses

(a) Any Federal agency may perform the analyses required by sections 602, 603, and 604 of this title in conjunction with or as a part of any other agenda or analysis required by any other law if such other analysis satisfies the provisions of such sections.

(b) Sections 603 and 604 of this title shall not apply to any proposed or final rule if the head of the agency certifies that the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities. If the head of the agency makes a certification under the preceding sentence, the agency shall publish such certification in the Federal Register at the time of publication of general notice of proposed rulemaking for the rule or at the time of publication of the final rule, along with a statement providing the factual basis for such certification. The agency shall provide such certification and statement to the Chief Counsel for Advocacy of the Small Business Administration.

(c) In order to avoid duplicative action, an agency may consider a series of closely related rules as one rule for the purposes of sections 602, 603, 604 and 610 of this title.

§ 606. Effect on other law

The requirements of sections 603 and 604 of this title do not alter in any manner standards otherwise applicable by law to agency action.

§ 607. Preparation of analyses

In complying with the provisions of sections 603 and 604 of this title, an agency may provide either a quantifiable or numerical description of the effects of a proposed rule or alternatives to the proposed rule, or more general descriptive statements if quantification is not practicable or reliable.

§ 608. Procedure for waiver or delay of completion

(a) An agency head may waive or delay the completion of some or all of the requirements of section 603 of this title by publishing in the Federal Register, not later than the date of publication of the final rule, a written finding, with reasons therefor, that the final rule is being promulgated in response to an emergency that makes compliance or timely compliance with the provisions of section 603 of this title impracticable.

(b) Except as provided in section 605(b), an agency head may not waive the requirements of section 604 of this title. An agency head may delay the completion of the requirements of section 604 of this title for a period of not more than one hundred and eighty days after the date of publication in the Federal Register of a final rule by publishing in the Federal Register, not later than such date of publication, a written finding, with reasons therefor, that the final rule is being promulgated in response to an emergency that makes timely compliance with the provisions of section 604 of this title impracticable. If the agency has not prepared a final regulatory analysis pursuant to section 604 of this title within one hundred and eighty days from the date of publication of the final rule, such rule shall lapse and have no effect. Such rule shall not be repromulgated until a final regulatory flexibility analysis has been completed by the agency.

§ 609. Procedures for gathering comments

(a) When any rule is promulgated which will have a significant economic impact on a substantial number of small entities, the head of the agency promulgating the rule or the official of the agency with statutory responsibility for the promulgation of the rule shall assure that small entities have been given an opportunity to participate in the rulemaking for the rule through the reasonable use of techniques such as—

(1) the inclusion in an advanced notice of proposed rulemaking, if issued, of a statement that the proposed rule may have a significant economic effect on a substantial number of small entities;

(2) the publication of general notice of proposed rulemaking in publications likely to be obtained by small entities;

(3) the direct notification of interested small entities;

(4) the conduct of open conferences or public hearings concerning the rule for small entities including soliciting and receiving comments over computer networks; and

(5) the adoption or modification of agency procedural rules to reduce the cost or complexity of participation in the rulemaking by small entities.

(b) Prior to publication of an initial regulatory flexibility analysis which a covered agency is required to conduct by this chapter—

(1) a covered agency shall notify the Chief Counsel for Advocacy of the Small Business Administration and provide the Chief Counsel with information on the potential impacts of the pro-

posed rule on small entities and the type of small entities that might be affected;

(2) not later than 15 days after the date of receipt of the materials described in paragraph (1), the Chief Counsel shall identify individuals representative of affected small entities for the purpose of obtaining advice and recommendations from those individuals about the potential impacts of the proposed rule;

(3) the agency shall convene a review panel for such rule consisting wholly of full time Federal employees of the office within the agency responsible for carrying out the proposed rule, the Office of Information and Regulatory Affairs within the Office of Management and Budget, and the Chief Counsel;

(4) the panel shall review any material the agency has prepared in connection with this chapter, including any draft proposed rule, collect advice and recommendations of each individual small entity representative identified by the agency after consultation with the Chief Counsel, on issues related to subsections 603(b), paragraphs (3), (4) and (5) and 603(c);

(5) not later than 60 days after the date a covered agency convenes a review panel pursuant to paragraph (3), the review panel shall report on the comments of the small entity representatives and its findings as to issues related to subsections 603(b), paragraphs (3), (4) and (5) and 603(c), provided that such report shall be made public as part of the rulemaking record; and

(6) where appropriate, the agency shall modify the proposed rule, the initial regulatory flexibility analysis or the decision on whether an initial regulatory flexibility analysis is required.

(c) An agency may in its discretion apply subsection (b) to rules that the agency intends to certify under subsection 605(b), but the agency believes may have a greater than de minimis impact on a substantial number of small entities.

(d) For purposes of this section, the term "covered agency" means the Environmental Protection Agency and the Occupational Safety and Health Administration of the Department of Labor.

(e) The Chief Counsel for Advocacy, in consultation with the individuals identified in subsection (b)(2), and with the Administrator of the Office of Information and Regulatory Affairs within the Office of Management and Budget, may waive the requirements of subsections (b)(3), (b)(4), and (b)(5) by including in the rulemaking record a written finding, with reasons therefor, that those requirements would not advance the effective participation of small entities in the rulemaking process. For purposes of this subsection, the factors to be considered in making such a finding are as follows:

(1) In developing a proposed rule, the extent to which the covered agency consulted with individuals representative of affected small entities with respect to the potential impacts of the rule and took such concerns into consideration.

(2) Special circumstances requiring prompt issuance of the rule.

(3) Whether the requirements of subsection (b) would provide the individuals identified in subsection (b)(2) with a competitive advantage relative to other small entities.

§ 610. Periodic review of rules

(a) Within one hundred and eighty days after the effective date of this chapter, each agency shall publish in the Federal Register a plan for the periodic review of the rules issued by the agency which have or will have a significant economic impact upon a substantial number of small entities. Such plan may be amended by the agency at any time by publishing the revision in the Federal Register. The purpose of the review shall be to determine whether such rules should be continued without change, or should be amended or rescinded, consistent with the stated objectives of applicable statutes, to minimize any significant economic impact of the rules upon a substantial number of such small entities. The plan shall provide for the review of all such agency rules existing on the effective date of this chapter within ten years of that date and for the review of such rules adopted after the effective date of this chapter within ten years of the publication of such rules as the final rule. If the head of the agency determines that completion of the review of existing rules is not feasible by the established date, he shall so certify in a statement published in the Federal Register and may extend the completion date by one year at a time for a total of not more than five years.

(b) In reviewing rules to minimize any significant economic impact of the rule on a substantial number of small entities in a manner consistent with the stated objectives of applicable statutes, the agency shall consider the following factors—

(1) the continued need for the rule;

(2) the nature of complaints or comments received concerning the rule from the public;

(3) the complexity of the rule;

(4) the extent to which the rule overlaps, duplicates or conflicts with other Federal rules, and, to the extent feasible, with State and local governmental rules; and

(5) the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule.

(c) Each year, each agency shall publish in the Federal Register a list of the rules which have a significant economic impact on a substantial number of small entities, which are to be reviewed pursuant to this section during the succeeding twelve months. The list shall include a brief description of each rule and the need for and legal basis of such rule and shall invite public comment upon the rule.

§ 611. Judicial review

(a) (1) For any rule subject to this chapter, a small entity that is adversely affected or aggrieved by final agency action is entitled to judicial review of agency compliance with the requirements of sections 601, 604, 605(b), 608(b), and 610 in accordance with chapter 7. Agency compliance with sections 607 and 609(a) shall be judicially reviewable in connection with judicial review of section 604.

(2) Each court having jurisdiction to review such rule for compliance with section 553, or under any other provision of law, shall have jurisdiction to review any claims of noncompliance with sections 601, 604, 605(b), 608(b), and 610 in accordance with chapter 7. Agency compliance with sections 607 and 609(a) shall be judicially reviewable in connection with judicial review of section 604.

(3) (A) A small entity may seek such review during the period beginning on the date of final agency action and ending one year later, except that where a provision of law requires that an action challenging a final agency action be commenced before the expiration of one year, such lesser period shall apply to an action for judicial review under this section.

(B) In the case where an agency delays the issuance of a final regulatory flexibility analysis pursuant to section 608(b) of this chapter, an action for judicial review under this section shall be filed not later than—

(i) one year after the date the analysis is made available to the public, or

(ii) where a provision of law requires that an action challenging a final agency regulation be commenced before the expiration of the 1-year period, the number of days specified in such provision of law that is after the date the analysis is made available to the public.

(4) In granting any relief in an action under this section, the court shall order the agency to take corrective action consistent with this chapter and chapter 7, including, but not limited to —

(A) remanding the rule to the agency, and

(B) deferring the enforcement of the rule against small entities unless the court finds that continued enforcement of the rule is in the public interest.

(5) Nothing in this subsection shall be construed to limit the authority of any court to stay the effective date of any rule or provision thereof under any other provision of law or to grant any other relief in addition to the requirements of this section.

(b) In an action for the judicial review of a rule, the regulatory flexibility analysis for such rule, including an analysis prepared or corrected pursuant to paragraph (a)(4), shall constitute part of the entire record of agency action in connection with such review.

(c) Compliance or noncompliance by an agency with the provisions of this chapter shall be subject to judicial review only in accordance with this section.

(d) Nothing in this section bars judicial review of any other impact statement or similar analysis required by any other law if judicial review of such statement or analysis is otherwise permitted by law.

§ 612. Reports and intervention rights

(a) The Chief Counsel for Advocacy of the Small Business Administration shall monitor agency compliance with this chapter and shall report at least annually thereon to the President and to the Committees on the Judiciary and Small Business of the Senate and House of Representatives.

(b) The Chief Counsel for Advocacy of the Small Business Administration is authorized to appear as amicus curiae in any action brought in a court of the United States to review a rule. In any such action, the Chief Counsel is authorized to present his or her views with respect to compliance with this chapter, the adequacy of the rulemaking record with respect to small entities and the effect of the rule on small entities.

(c) A court of the United States shall grant the application of the Chief Counsel for Advocacy of the Small Business Administration to appear in any such action for the purposes described in subsection (b).

Executive Order 13272

Federal Register
Vol. 67, No. 159
Friday, August 16, 2002

Presidential Documents

Title 3—

The President

Executive Order 13272 of August 13, 2002

Proper Consideration of Small Entities in Agency Rulemaking

By the authority vested in me as President by the Constitution and the laws of the United States of America, it is hereby ordered as follows:

Section 1. *General Requirements.* Each agency shall establish procedures and policies to promote compliance with the Regulatory Flexibility Act, as amended (5 U.S.C. 601 *et seq.*) (the "Act"). Agencies shall thoroughly review draft rules to assess and take appropriate account of the potential impact on small businesses, small governmental jurisdictions, and small organizations, as provided by the Act. The Chief Counsel for Advocacy of the Small Business Administration (Advocacy) shall remain available to advise agencies in performing that review consistent with the provisions of the Act.

Sec. 2. *Responsibilities of Advocacy.* Consistent with the requirements of the Act, other applicable law, and Executive Order 12866 of September 30, 1993, as amended, Advocacy:

(a) shall notify agency heads from time to time of the requirements of the Act, including by issuing notifications with respect to the basic requirements of the Act within 90 days of the date of this order;

(b) shall provide training to agencies on compliance with the Act; and

(c) may provide comment on draft rules to the agency that has proposed or intends to propose the rules and to the Office of Information and Regulatory Affairs of the Office of Management and Budget (OIRA).

Sec. 3. *Responsibilities of Federal Agencies.* Consistent with the requirements of the Act and applicable law, agencies shall:

(a) Within 180 days of the date of this order, issue written procedures and policies, consistent with the Act, to ensure that the potential impacts of agencies' draft rules on small businesses, small governmental jurisdictions, and small organizations are properly considered during the rulemaking process. Agency heads shall submit, no later than 90 days from the date of this order, their written procedures and policies to Advocacy for comment. Prior to issuing final procedures and policies, agencies shall consider any such comments received within 60 days from the date of the submission of the agencies' procedures and policies to Advocacy. Except to the extent otherwise specifically provided by statute or Executive Order, agencies shall make the final procedures and policies available to the public through the Internet or other easily accessible means;

(b) Notify Advocacy of any draft rules that may have a significant economic impact on a substantial number of small entities under the Act. Such notifications shall be made (i) when the agency submits a draft rule to OIRA under Executive Order 12866 if that order requires such submission, or (ii) if no submission to OIRA is so required, at a reasonable time prior to publication of the rule by the agency; and

(c) Give every appropriate consideration to any comments provided by Advocacy regarding a draft rule. Consistent with applicable law and appropriate protection of executive deliberations and legal privileges, an agency shall include, in any explanation or discussion accompanying publication in the **Federal Register** of a final rule, the agency's response to any written comments submitted by Advocacy on the proposed rule that preceded the final rule; provided, however, that such inclusion is not required if the head of the agency certifies that the public interest is not served thereby. Agencies and Advocacy may, to the extent permitted by law, engage in an exchange of data and research, as appropriate, to foster the purposes of the Act.

Sec. 4. *Definitions.* Terms defined in section 601 of title 5, United States Code, including the term "agency," shall have the same meaning in this order.

Sec. 5. *Preservation of Authority.* Nothing in this order shall be construed to impair or affect the authority of the Administrator of the Small Business Administration to supervise the Small Business Administration as provided in the first sentence of section 2(b)(1) of Public Law 85–09536 (15 U.S.C. 633(b)(1)).

Sec. 6. *Reporting.* For the purpose of promoting compliance with this order, Advocacy shall submit a report not less than annually to the Director of the Office of Management and Budget on the extent of compliance with this order by agencies.

Sec. 7. *Confidentiality.* Consistent with existing law, Advocacy may publicly disclose information that it receives from the agencies in the course of carrying out this order only to the extent that such information already has been lawfully and publicly disclosed by OIRA or the relevant rulemaking agency.

Sec. 8. *Judicial Review.* This order is intended only to improve the internal management of the Federal Government. This order is not intended to, and does not, create any right or benefit, substantive or procedural, enforceable at law or equity, against the United States, its departments, agencies, or other entities, its officers or employees, or any other person.

THE WHITE HOUSE,
August 13, 2002.

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The State of Small Business: A Report of the President, 1982–2000

Editions of *The Small Business Economy* and *The State of Small Business* for 1996 thorough the present are available on the Office of Advocacy website at http://www.sba.gov/advo/research/ or by contacting the Office of Advocacy at 202 205-6933. Earlier editions of *The State of Small Business* may be accessed through the National Technical Information Service at www.ntis.gov or National Technical Information Service, 5285 Port Royal Rd., Springfield, VA 22161, (800) 553-6847 or (703) 605-6000, TDD (703) 487-4639.

2006 THE SMALL BUSINESS ECONOMY: A REPORT TO THE PRESIDENT

2005 THE SMALL BUSINESS ECONOMY: A REPORT TO THE PRESIDENT

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