

The Third Millennium: Small Business and Entrepreneurship in the 21st Century

Office of Advocacy
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Preface

In preparation for the 1995 White House Conference on Small Business, the Office of Advocacy convened a series of focus groups and commissioned a set of research papers looking ahead at the trends and issues expected to affect small business at the turn of the new century. The results were published in the 1995 edition of *The Third Millennium: Small Business and Entrepreneurship in the 21st Century*.

With five more years of history to add to our data, we thought it was time to take another look and see whether our expectations were right. So the Office of Advocacy convened several more focus groups, of former 1995 White House Conference delegates, small business leaders, and futurists, and gathered the available new data.

I'm pleased to report that many of our predictions have been right on target. Some events — for example, technological developments and related phenomena, such as the connectivity fostered by the Internet — are occurring even faster than expected. Other trends continue at a slightly slower pace than earlier predictions suggested.

So as the Third Millennium begins, this report presents a picture of where small business stands and where it is likely to be over the next several years. If you'd like to know more, you can visit the Office of Advocacy's Web site at www.sba.gov/advo/stats — or call us at (202) 205-6533.

It is my hope that this information will help you and other small business owners, advocates, and policy makers prepare for the many challenges just ahead. I welcome your comments and questions-and, as always, your efforts on behalf of small business.



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Introduction

The American small business community has never been more diverse or more vigorous, propelled by a decade of economic growth, opportunity, and fast-paced change in almost every aspect of American life. But the nation's thriving small business economy would be even more robust if small firms were allowed to operate in a fully competitive environment, unconstrained by capital and labor shortages.

The output of the economy (measured in gross domestic product) will almost double from the 1980 level by 2010, with services and retail trade leading the way. The manufacturing sector is expected to lose jobs, but increase output (indicating increased productivity) over the same period. In the service industries, employment is expected to increase significantly, output slightly less. While federal government employment has declined by 300,000 since 1992, employment in state and local governments will grow, driving up overall government employment.

What is the outlook for small businesses as the 21st century opens on an era of prosperity and economic expansion? The labor shortage and difficulty in filling vacant positions top the list of concerns for most small firms. Fully one-third of firms surveyed in 1998 listed "finding qualified employees" as their number one problem. Another major concern, listed by 37 percent was the increase in insurance and health care costs.

These kinds of problems can be considered "external" to the firm in that they are beyond the control of any single small business owner. But they are not likely to be short-term. Because of declining birth rates and an aging labor force, such conditions will be part of the small business environment well into the 21st century.

New and rapidly changing technologies and the power of electronic commerce, or "e-commerce," are emerging long-term forces likely to affect the entire spectrum of small businesses. Smaller firms have control over some aspects of this new environment: many are establishing Web sites and becoming electronic merchants. But in other situations, they will be reacting to the demands of their customers or to the competitive pressures of other similar firms and the costs imposed upon them by Internet service providers. It is reasonable to expect that the technology revolution will continue to pose both internal and external challenges for small firms into the new century.

Table A U.S. Projections, 1980-2010

	1980	1990	2000	2010	% Change 1980- 2010
Population (Thousands)					
Total	226,549	249,402	276,241	300,431	32.6
Under 18	63,755	64,156	71,789	73,617	15.5
18-64	137,240	154,011	169,131	186,709	36.0
65 and over	25,549	31,235	35,322	40,104	57.0
Employment (Thousands of Jobs)					
All-Industry Total	113,726	138,981	157,656	176,164	54.9
Manufacturing	20,777	19,756	18,890	18,850	(9.3)
Retail Trade	17,853	23,020	26,402	29,450	65.0
Services	24,558	38,188	49,474	59,379	141.8
Government	18,796	21,203	23,065	24,750	31.7
Other	31,743	36,815	39,825	43,737	37.8
Gross State Product (Millions of 1987 Dollars)					
All-Industry Total	3,697,140	4,888,324	6,025,600	7,219,400	95.3
Manufacturing	725,428	928,483	1,105,409	1,279,410	76.4
Retail Trade	320,134	478,080	603,150	726,774	127.0
Services	609,012	869,360	1,103,812	1,371,477	125.2
Government	494,431	564,163	617,863	686,916	38.9
Other	1,548,135	2,048,238	2,595,367	3,154,824	103.8

Source: U.S. Small Business Administration, Office of Advocacy, from data provided by the Bureau of Economic Analysis.

The Findings: Four Themes

This report updates the Office of Advocacy's 1995 publication titled *The Third Millennium: Small Business and Entrepreneurship in the 21st Century*, first published before the 1995 White House Conference on Small Business. Some trends are new or have accelerated—witness the rapid evolution of e-commerce and changes in communications technologies, for example. But many trend lines—long-term demographic changes and gaps in working capital—look much the same as they did in 1995. The four themes originally explored in the 1995 document are therefore revisited in the present edition:

- Theme 1: Rapid change will continue and a sense of impermanence will grow.
- Theme 2: Heterogeneity, diversity, and complexity will continue to be hallmarks of the small business sector

- Theme 3: Small businesses will continue to face barriers to entry and inhibitors of growth
- Theme 4: The small business and entrepreneurial sector will continue to be strong.

The Office of Advocacy recently conducted two focus groups to examine these very themes. One involved delegates from the 1995 White House Conference looking at today's small business environment and what the delegates expect will be the small business environment in the year 2010. A second focus group of futurists examined trends most likely to affect small business at the beginning of the new millennium.

These groups found the predictions of the 1995 *Third Millennium* report to have been largely valid, but noted that many technological advancements had occurred even more rapidly than anticipated. Rapid technological change was seen as having both positive effects and potentially negative repercussions. Small businesses can now compete more effectively, as technology allows them access to a larger audience and gives them some advantages even over larger corporations that may not be able to move quickly enough in the new fast-paced marketplace. The most worrisome issue, in the eyes of these focus group participants, is that many in the work force may not be prepared to make effective use of the new technologies at their disposal.

Theme 1: Rapid change will continue and a sense of impermanence will grow

The American economy and society—the setting for both large and small businesses—are undergoing rapid and fundamental changes, expected to continue into the 21st century. The rapidity of change and its fundamental nature have engendered an essential sense of impermanence and time pressure. Such pressures have brought into question basic elements of how businesses, society, and the economy operate.

Insight 1: Downsizing signals restructuring

The downsizing phenomenon in manufacturing has spread to other large organizations in society, specifically, parts of government and the communications sector. Downsizing in larger corporations and the outsourcing of many functions previously performed internally offer new opportunities for small businesses. The “social contract” that many large firms and governmental units had with their employees—white collar, blue

collar, and pink collar—held that their loyalty, commitment, and diligence would be rewarded. They would receive opportunities for advancement, increased wages, and the security of career-long employment, buttressed by a full panoply of fringe benefits, including a pension. As some employees of such national companies as NationsBank, U.S. Steel, IBM, AT&T, and even large local banks and public utilities have found, many of the promises in the implied social contract have been eroded in the corporate reorganizations and downsizings of the mid-1990s. Suddenly, the attractiveness of careers in large businesses has changed drastically in comparison with the rewards associated with entrepreneurship and working in the small business sector.

Self-employment, the starting place for many entrepreneurs, has increased rapidly over the last three decades, particularly in nonagricultural industries. Over the 1966-2006 span, the increase in self-employment as a primary occupation is expected to be almost 50 percent, primarily because of growth in the labor force. Some 10.5 million people were self-employed in 1996, up by more than 3 million from 1976. The self-employment rate—self-employment as a percentage of the civilian labor force—is expected to level off at around 8 percent by 2006. Few self-employed individuals have employees, and those who do have very few employees, so the self-employed are, by definition, very small businesses.

Like self-employment, home-based business ownership has exploded in recent years. Home-based businesses represent more than half (52 percent) of all small firms and provided 10 percent of the total receipts in the economy—about \$314 billion in 1992.

The period of corporate downsizing in the early 1990s was followed by a period of giant corporate mergers, with additional downsizing, in the latter half of the decade. This compression, in some sectors, of many large firms into a few very large firms has changed the environment for growing a new firm. Small firms may have to become larger small firms in order to compete if economies of scale continue to grow through the next decade.

And organizational change may be a hallmark of the next few years, at least according to the 1999 focus groups. They repeated numerous times that new individuals entering the work force will have less trouble adjusting to a pattern of constant change because they will have known no other environment. The old social context may have become an anachronism; the rapid pace of the economy will seem normal.

***Insight 2:
Globalization
will increasingly
influence how
small businesses
operate***

Globalization—the growing impetus to think and act on a worldwide scale—will continue to modify and mold the environment for small business and entrepreneurship over the next decade and beyond. Increasingly, small firms, including many start-ups, are identifying foreign markets and foreign sources of supply through the Internet as important parts of their strategies for growth and success.

Because of the Internet, small businesses are also facing more foreign competition in the products and services they both provide and purchase. The competition from abroad places strong pressure on small businesses in terms of efficiency, price, quality, cost control, marketing, expertise, customer satisfaction, and innovativeness.

The globalization of the economy probably means that more and more new firms must export from their inception in order to be competitive. But they will profit from globalization only if it gives them access to new markets. To be competitive, they may have to identify “niche” markets.

According to the most recent (1997) data from the U.S. Department of Commerce, although only a small percentage of all firms export, the number of small firms that export has tripled over the last decade, from 69,354 in 1987 to 209,455 in 1997. Most of the growth in exporting firms over the 1992-1997 period was in companies with fewer than 20 employees, which made up 65 percent of all exporting firms in 1997. Barriers to trade, such as tariffs and quotas, can only hinder small firms’ continued entrance into the global economy.

Some participants in the focus groups expressed concern that the small business community is not yet prepared to deal with the impact of globalization. However, many are clearly beginning to enter export markets.

***Insight 3:
Advances in
technology will
affect the competi-
tiveness of small
businesses***

Various experts have attributed up to one-half of U.S. economic growth since 1995 to rapid increases in productivity resulting from the expansion of the digital economy. With about half of the small business sector having a Web site, and about one-quarter processing electronic transactions (e-commerce), market penetration—and the markets themselves—are changing overnight.

The revolution in electronic technology is likely to accelerate. Whether small firms will prosper on the Internet or come to view it as another fixed cost necessary to maintain their present client base is an open question. This aspect of the small business

environment will continue to evolve as small firms develop more creative and profitable uses for the Internet.

One of the focus groups noted an interesting side effect of these technological advances. In order to compete effectively in the rapidly changing economic environment, big businesses (and big government) are having to subdivide their internal functions into essentially self-contained units that function like small businesses.

***Insight 4:
New patterns of
“connectivity”
will develop
among firms***

The next decade will see an increase in the connectivity between and among organizations and markets. Already, firms are electronically connected with their customers and vendors. Customers use desktop publishing to send copy and graphics to their printers. On-line searches of international data bases are routine. The types and uses of connectivity will continue to expand.

Connectivity is fostering the development of new organizational relationships among entities. Alliances of small firms, self-employed individuals, and larger organizations connected by advanced computer and communications technologies are allowing geographically diverse organizations to interact and work creatively to produce goods and services all over the world. Many of these strategic alliances are temporary: at the end of a particular project or series of projects, they dissolve and may or may not come together again. Some persons and firms that rely on traditional stability are threatened in the process, while adaptable firms and individuals prosper.

Increased flexibility and connectivity will both allow and require small businesses to be more responsive to their customers' particular needs. The development and design of new customized products will both give small firms an advantage and put pressure on them to produce customized products with greater speed than ever before. Small firms must diversify to a greater extent to maximize their ability to respond rapidly to new demands for products and services.

Economic growth will rely on more and better connectivity within and among all the economy's constituent parts—industry groups, suppliers, business and financial, and a variety of other service providers, governments, the media, entrepreneurs and their customers.

Theme 2: Heterogeneity, diversity, and complexity will continue to be hallmarks of the small business sector

By history and by nature, the small business and entrepreneurial portion of the U.S. economy and society is an increasingly rich stew of diversity and complexity. The heterogeneity, diversity, and complexity that make generalizations so difficult are the very characteristics that represent the strength and vitality of the small business sector.

How small firms will operate and the kinds of workers they will employ are expected to change in the future. With the aging of the work force and far-reaching computer-era changes, small businesses must evolve to survive. As in the industrial revolution and previous eras of great change, small businesses that take advantage of new opportunities will thrive, while those that do not will close.

***Insight 5:
Heterogeneous
small businesses
will continue to
be challenged by
the variety of
their differences***

In the final analysis, there is no “typical” small business or entrepreneur. To participate in programs sponsored by the U.S. Small Business Administration, all that is required is that the firm fall below some sales or employment size threshold. (In employment, for example, the threshold is often 500 workers.)

Below these size thresholds are an amazing variety of firms. Most firms begin small and remain small throughout their life cycle. A very small percentage grow to moderate size. A smaller minority grow to be large and even fewer become giant firms. These are the so-called “gazelles” whose contributions to employment and growth constitute modern legends.

As mentioned previously, the diverse array of small firms will include more home-based businesses. Larger firms and larger small firms will continue to establish tele-work centers to maximize productivity. More small firms are likely to do the same. The Internet may influence the decision to become self-employed vs. working for someone else. And more women and minorities are starting businesses (see insights 7 and 8).

***Insight 6:
The nature and form
of small firms will
continue to evolve***

Changes in technology, markets, and values will encourage the evolution of new types of firms. Advances in computers, software, communications, and related technologies are already affecting the form and operational structure of both existing and emerging enterprises. “Clusters of competencies” and strategic alliances—with self-employed individuals, small firms, and representatives of larger organizations often connected primarily by computer and

communications networks and often working at great distances from each other—are expected to increase rapidly in number and importance over the next decade. These clusters can be created quickly, can work intensely on projects or a series of projects, and can just as quickly be disbanded. The self-employed individuals and small organizations included in these strategic alliances or clusters of competencies can, for a time, perform almost like traditional businesses. In the future, even more than in the past, it may be difficult to identify what exactly is a business.

The Internet has clearly increased the combinations of firms observed less than five years ago. It is no longer uncommon for small U.S. firms to partner with firms in Europe, Asia, or Latin America. This phenomenon will likely increase dramatically in the future. It is also likely that domestic home-based firms will increase their partnerships with non-home-based firms to collaborate on individual projects. More small firms will continue to become virtual corporations, stopping and starting on a project-by-project basis.

The focus groups showed strong interest in the idea of virtual corporations. One participant noted that a good example of how a virtual corporation works would be the making of a commercially released film. A producer contracts with a studio to deliver a movie that the studio pays for. The producer then hires independent workers for different jobs, forming one cohesive film crew or company. Once the movie is completed, this company disbands. Focus group participants suggested that many businesses, both large and small, will operate as such virtual corporations in the future.

Despite the evolving nature of small firms and their relationships, their aggregate share of the economy has been remarkably stable over the past 30 years (Table B).

***Insight 7:
Small businesses
will face an aging
and increasingly
diverse work force***

One area about which predictions can be made with a great deal of confidence is the demographics of the population and the labor force (see graphical appendix). Over the next decade, the large baby boom generation will be moving into their 50s and 60s. The average age of the work force will rise. The labor force will be more experienced and productive. An aging work force may also mean more part-time workers, more job-sharing, and greater worker turnover. Replacements for the retiring baby boom generation will be hard to find as labor force growth declines to below 2 percent annually.

Table B Small Business Share of the Private Sector Nonfarm Economy

	Small Firms' Share of Output	Small Business Share of the Private Sector Nonfarm Economy (Percent)		
		Establishments	Employment	Payroll
1995	NA	99.8	80.1	74.3
1990	51.0	99.8	79.9	73.6
1985	52.0	99.8	79.8	72.8
1980	52.0	99.7	78.1	71.1
1975	53.0	99.7		
1970	54.0	99.7		
1965	54.0	99.7		
1959	57.0	99.8		

Small is defined as having fewer than 500 employees. A firm is an aggregation of all establishments owned by a parent company, and an establishment is a business location that has employees.

Sources: Output from a contract funded by the Office of Advocacy and produced by Joel Popkin and Company (1997). Small establishment data from Bureau of the Census, *County Business Patterns* (reporting criteria changed in 1983 and 1974, but they should not have much impact on the small share).

A number of the focus group participants believed that, as the work force ages and technology develops, there will be a difficult transition period in which many in the work force do not understand or feel comfortable with the technological tools at their disposal.

New entrants into the labor force increasingly will be women, minorities, and immigrants. White males will constitute only about one-seventh of the net growth in the U.S. labor force. Almost one-fourth will be immigrants.

Individuals of Hispanic origin will represent almost one-third of the increase in the labor force from 1986 to 2006, and will rise to about 12 percent of the labor force by 2006 (Table C). Hispanic Americans will surpass African Americans as the largest minority in the labor force by 2006. One-quarter of the work force will be Hispanic by 2050. Asians will more than quadruple their numbers in the labor force from 1976 to 2006.

While the share of white non-Hispanic individuals will decline to about 73 percent of the labor force by 2006, this group will still represent about half of the labor force increase from 1986 to 2006 (from 94 million in 1986 to 108.2 million in 2006).

The diversity of the work force has changed faster than was anticipated five years ago. Immigration of Hispanic and Asian

Table C. Civilian Labor Force by Race and Origin, 1976-2006

	Total	Race (Millions)				Percent		
		White	Black	Asian	Hispanic	Asian	Hispanic	Black
1976	96.2	84.8	9.6	1.8	--	1.9	--	9.9
1986	117.8	101.8	12.7	3.4	8.1	2.9	6.9	10.8
1996	133.9	113.1	15.1	5.7	12.8	4.3	9.5	11.3
2006	148.8	123.6	17.2	8.0	17.4	5.4	11.7	11.6

Source: Bureau of Labor Statistics.

workers and entrepreneurs has escalated, and white men are retiring earlier. Not yet understood are the effects the changing demographics of the work force will have on the productivity and profitability of the typical small business. There will be implications for small business in the aging and increasingly diverse work force, especially with respect to health care and increased training needs.

It seems clear that today's labor shortages, particularly of entry-level workers, are here to stay for some time. Focus group participants expressed concern about the language, math, and writing skills of new labor force entrants, as well as the high cost to small firms of remedial training.

***Insight 8:
The number of
women business
owners will
increase***

Over the last decade and a half, the number of women-owned businesses has been growing at a rate twice that of male-owned businesses, and there is every indication that women-owned firms will continue to increase over the next decade. However, some slowdown will occur as a result of the slowing rate of entry of women into the labor force. Nevertheless, the percentage of working women in the labor force continues to close the gap with men (Table D).

Women business owners face all the problems faced by other small business owners, though their concerns may differ in degree, nature, and extent. Certain problems continue to affect women business owners more, such as securing adequate child care and access to capital.

“Channeling” is a problem that continues to limit the number of women business owners and entrepreneurs. Some girls are discouraged at an early age from pursuing educational and work opportunities likely to lead to degrees in business and engineering and from looking at business ownership and entrepreneurship as a desired career path. Until recently, the paucity of women role

Table D Civilian Labor Force by Gender, 1966-2006 (Millions of Workers)

	Total	Men	Women	Percent Women	Percent Total Increase
1966	77.1	49.8	27.3	35.4	--
1976	99.5	60.5	39.0	39.2	29.1
1986	117.8	65.4	52.4	44.5	18.4
1996	133.9	72.1	61.9	46.2	13.7
2006	148.8	78.2	70.6	47.4	11.1

Source: Bureau of Labor Statistics.

models and the lack of networks of successful women entrepreneurs, business owners, and professionals reinforced the influence of channeling. Increasingly, programs are being started to encourage girls to consider the full panoply of educational and career possibilities. Active networks of successful business owners and professionals have been created, and successful women increasingly seek and hold leadership positions in traditional small business groups.

Women-owned firms with employees have grown relatively rapidly over the past five years. Larger women-owned firms are likely to grow through angel and venture capital financing in the future as more successful women entrepreneurs reinvest in other women-owned businesses and more angel networks are formed.

***Insight 9:
Minority business owners will continue to face difficult challenges***

While minority small business ownership and entrepreneurship have increased over the last several decades, significant patterns remain unchanged. Only 15 percent of minority-owned firms have employees, and this percentage must increase in the future if a larger share of the minority business community is to share in continued economic growth. Recent studies have found worrisome differences in minority business owners' ability to obtain credit. With the New Markets Initiative, many parts of the SBA, as well as other federal and state and local government agencies, are working to increase the availability of capital and mentors for minority entrepreneurs.

Theme 3: Small businesses will continue to face barriers to entry and inhibitors of growth

***Insight 10:
Access to credit will be difficult***

Adequate financing for rapidly growing firms will be America's greatest economic policy challenge of the new century. For many small businesses, especially in the early years, business credit is simply not available. Multiple credit card balances and home equity loans are major sources of credit for startup firms.

Lending to manufacturing concerns with hard assets such as real property, equipment, and inventory has always been easier than lending to service-sector firms, where human resources are more important. Loans to non-manufacturing firms require more judgments in terms of character, markets, and cash flow, but have been more often based on credit scoring models. Encouraging banks and investment regulators to look at the creditworthiness of all small business loans in their portfolio as a group, rather than at each individual loan, would be an improvement.

The banking industry and the entire financial sector have undergone many large mergers. By 2010, the distinctions among banks and other financial institutions will be greatly reduced, and the structure of the banking industry itself will continue to change.

It is expected that the banking industry will be divided into global, national, and super-regional banks, with a much smaller number of community banks. Larger banks (primarily the super-regional banks), to the extent that they serve small business needs, will do so through large loan processing centers utilizing credit scoring techniques with “intelligent models” (artificial intelligence—derived computer-based models). The resulting loans will be highly standardized, “cookie-cutter” loans. The much diminished number of community banks will be left to serve, as well as they can, the needs of small businesses that do not meet the screens of scoring techniques and intelligent models.

Some new banks are being formed by bank executives of merged banks, and these banks are partially replacing the character loans once made by the merged banks. There is some hope that the evolving non-bank financial institutions—insurance companies, finance companies, pension funds, private/public sector cooperative organizations, and state and local government-sponsored organizations—can address the credit needs of small businesses and entrepreneurial firms.

At least for now, access to credit is less difficult than was expected five years ago. Banks and businesses are flush with cash because of the economic expansion. Because of credit scoring models and business credit cards offered by the merging national banks, the number of small loans is ballooning—but the average size of small business loans is dropping dramatically. Some credit is readily available but often at a higher cost and for a shorter time period. In addition, larger loans are becoming harder to secure.

Some recent studies have found that minority business owners, particularly African American and Hispanic business owners, have had particular difficulty obtaining credit.

Numerous participants in the focus groups noted that they expect to see a business downturn in the next several years, with a concomitant tightening of the loan market. What is unknown is how any downturn will affect existing businesses or which sectors will be affected more than others. Research has shown, however, that the impacts of such downturns generally fall more heavily on small firms, especially rural and minority-owned businesses.

***Insight 11:
Access to capital
will continue to
be a problem***

Access to capital at various stages in the life cycle of small businesses and entrepreneurs will continue to be a major problem. For many smaller firms and most startups, the personal funds of the business owner and entrepreneur and those of relatives and acquaintances constitute the major sources of startup capital. Recently, many refugees from downsizing large businesses have entered the world of small business and entrepreneurship, using personal resources and the proceeds of their severance packages.

Finding early-stage money to grow a business has always been difficult. The organized venture capital industry, while extremely important, funds only a tiny portion of the high-potential startup businesses. Over the last 25 years, the venture capital industry has matured. More than one-half of the resources of newly raised funds come from non-profits and pension funds. The size of the venture pools being raised is increasing, as is the size of the deals that venture partnerships are funding; they averaged \$7 million in 1998.

Venture funds—ever in search of larger deals—are stressing later-stage deals. Finding venture financing for moderate needs—say, between \$500,000 and \$1.5 million—is very difficult. SBA’s SBIC program is an important offset.

Sophisticated individual investors, often called “angels,” are another source of capital. Angel capital networks are also growing around the country as the new high-tech millionaires who have been successful in selling their companies are re-investing their wealth in new high-tech startups and looking for new investments. An estimated \$70-\$80 billion is in the angel capital market as of 1999.

Some advances have been made toward rationalizing and organizing angel financing through a national marketplace for angel capital—via the Internet—for example, the ACE-Net, or

Angel Capital Electronic Network project. But much more needs to be done. Targeted tax initiatives may be needed to encourage this source of financing to meet the continuing needs of small businesses in the next decade.

In some industries, where the product or service development life cycle is especially long, there is a need for more patient capital. New initiatives may require increased participation by state and local governments, particularly using seed capital or pension funds.

***Insight 12:
There is an
increasing need
for effective
education and
training***

For small businesses and entrepreneurs to be successful over the next decade and beyond, an educated and trained work force must be available. There is almost universal agreement that public school systems are not meeting the needs of the small business community in preparing new labor force entrants with such basic skills as literacy, math, and problem solving.

The focus group participants also expressed concern that the educational system is producing a generation of workers who have good computer and Internet skills but who are not adequately prepared for many of the tasks and jobs they will face.

For students who extend their education beyond the high school level, there is a need for education in how the economic system works and skills training for careers in small business. The popularity of courses in entrepreneurship and small business in the nation's business schools over the last decade indicates that this need is beginning to be addressed, at least at the college level.

Most small firms now identify labor shortages and the ability to obtain skilled labor at reasonable rates as their number one problem. This was generally not an issue five years ago. But the problem is expected to continue into the next century because of changing work force demographics. The Office of Advocacy has conducted studies of how state and federal training programs are used by small firms and how small firms are adjusting to the labor shortage environment. Small firms report they are feeling the effects of the labor shortage in lower profits and reduced employee morale.

***Insight 13:
Regulation is a
major impediment
to small business
and entrepreneurship***

The extent, complexity, and uncertainty associated with regulation is a major barrier to growth. From youth entrepreneurs telling horror stories about trying to secure vendor licenses, to bankers who see the risk associated with environmental laws as limiting their ability to make

loans, to high-tech entrepreneurs frustrated by the length, expense, complexity, and uncertainty of the Food and Drug Administration's approval process, regulation is seen as the major problem for startups in many sectors.

The burden of regulation tends to fall disproportionately on small enterprises. Larger enterprises can often hire internal and external help at a reasonable price and can spread cost over many more units of output.

Limiting the regulatory burden on small firms can both create a regulatory atmosphere that is fair to small businesses and generate benefits outweighing the regulatory costs. To minimize regulatory impediments to business entry and growth, the Office of Advocacy devotes significant resources to representing small business concerns in the development of proposed regulations by federal agencies.

Accurate data are needed if regulators are to study the real costs and benefits of regulation. Few data sources exist that break the economy down by the size of firms; however, the Office of Advocacy has funded a Census Bureau data base that can be used for regulatory analyses. Tabulations from this data base, titled Statistics of U.S. Business, are made available to the public for studies by firm size. In addition, an offshoot of this project, the Business Information Tracking System (BITS) allows approved researchers at the Census Bureau to create their own tabulations from Census data and to answer an infinite number of potential research questions about how proposed federal regulations will affect small firms.

Regulation is not exclusively a federal problem. One high-tech entrepreneur from California related how his company was subjected to regulation of a single process by six separate state and local jurisdictions with overlapping and often contradictory standards.

Small businesses generally agree that some regulation should be abandoned and that most regulation should be simplified and made more flexible. For the smallest firms, some exemptions are in order. Additional size-sensitive standards and regulatory processes should also be put in place. Small business owners believe that cost-benefit and risk assessment analyses should be required for all regulations and that local, state, and federal regulations should be coordinated and simplified.

The Office of Advocacy publishes an annual report on the implementation of the Regulatory Flexibility Act (RFA), the

statute that, along with the Small Business Regulatory Enforcement Fairness Act (SBREFA), generally governs small business regulatory analysis at the federal level. A number of Advocacy contract studies since the 1995 White House Conference on Small Business have also measured the disproportionate burden that virtually all regulations place on small firms. The passage of SBREFA in 1996 put teeth into the RFA by, among other things, adding a judicial review provision. Because of the strengthened RFA, some believe that federal regulations are becoming fairer to small firms. There are, however, surveys indicating that state and local regulations are becoming a more significant burden.

The members of the Office of Advocacy's recent focus groups repeatedly cited government regulations as a burden that must be lightened. One participant said it is up to government to catch up to the pace of the rapidly changing private sector. If government fails, it will become a brake that slows the growth rate of the new economy.

***Insight 14:
Small business
suffers from
inadequate data,
information,
and analysis***

Today's federal system of economic data collection and distribution, while improving with data sources like BITS and others—is still inadequate. It does not allow the dynamic role of small business and entrepreneurship to be fully understood and measured, nor does it allow problems to be analyzed or public policy responses to be developed and monitored on a current basis. (The latest data available are for 1996.)

By its very nature, the small business portion of the economy is turbulent and chaotic. Attempts to collect data on this sector are an immense challenge, and are extremely expensive. Budget cuts imply less data on small firms. Innovative approaches to data collection and sharing are needed.

Since 1995, some progress has been made toward building a data base by firm size using Census data and disseminating it via the Internet. Nevertheless, the lack of timely, current data on small business profits and performance continues to hamper the development of good, current statistical indicators measuring the size and contribution of the small business sector. The Internet and private sector data may be further utilized to remedy these problems, but anecdotal information is not usually acceptable. Innovative public-private sector partnerships are needed to address the demand for timely, nationally representative information for policy purposes.

For many years the study of small business and entrepreneurship in the academic community was relegated to a few professors

with scant regard for their academic careers. Over the last decade, some progress has been made. Business schools are identifying entrepreneurship as an area worthy of research. But the inadequacy of data has inhibited meaningful research on many small business and entrepreneurial issues.

Theme 4: The small business and entrepreneurial sector will continue to be strong.

***Insight 15:
Small firms will
continue to play
a dominant role
in job creation***

Small businesses will continue to be the engine of job generation. Smaller firms—those with fewer than 20 employees—generate most of the new jobs. Net new job creation will continue to be the result of “churning”—that is, small firm birth and death rates will continue to be high, with gains expressed in net new births.

New federal data sources have provided much more reliable information than has ever before been available about small firm job creation. Between 1990 and 1995, small firms created about 80 percent of the net new jobs. If anything, the mega-mergers—and the associated downsizing during the past few years—have raised this small business job creation share.

New rapidly growing firms—the so-called “gazelles”—appear to have increased their share of new job creation over the past few years. Whether this will change during the next few years depends upon the availability of capital and the general state of the economy. It is likely that small firms will need to grow faster and generate more jobs in the future in order to survive. Many of these changes are being driven by technology and technical changes that have the potential to enlarge markets.

***Insight 16:
Small firms
will continue
to contribute
to innovation
and technology,
but with difficulty***

Traditionally, small businesses have contributed more than their share to innovation and technological advances. More important, they have often played a unique role not only in developing technologies, but also in developing and exploiting unrealized market opportunities for those technologies. And, by combining new technology and new market development initiatives, they lay the groundwork for new industries.

Apple, Microsoft, Intel—small firms in the 1970s and 1980s—and a small number of other firms developed micro-computer technology and identified an unmet market need for the personal computer. The result was a whole new industry, the micro-computer industry, which in turn spawned numerous other new software and information technology sectors. The modest level—in relative terms—of small business sales and profits belies the importance of their function in developing entire new industries,

along with the jobs the new industries create. Between 1992 and 1996, small firms with fewer than 500 employees created 72 percent of the net new jobs in information technology sectors.

While small firms and entrepreneurs will continue to contribute to innovation and technological advances, the difficulties that exist today will continue. Several of the difficulties relate to government taxation and regulation, which can be especially burdensome for small technology-based firms at the startup stage. Issues such as rights to intellectual property and protection of proprietary technology often trouble small businesses needing to safeguard new technologies on the Internet. And gaps remain in long-term equity financing.

While small firms continue to contribute to innovation through a few federal programs, such as the SBIR program, there is continual need to keep justifying such programs, despite 40-50 percent commercialization rates and many supportive studies. In addition, federal labs and universities continue to challenge small firms for scarce research dollars.

***Insight 17:
The micro-
business move-
ment provides
economic
empowerment***

The micro-enterprise movement is based on the premise that all citizens should have opportunities for small business ownership. Micro-business programs provide very small loans, bundled with training and technical assistance, to make the dream of self-employment and small business ownership possible for people with social and economic disadvantages.

In 1986, micro-business programs were brought to the United States. The programs typically target historically underutilized and depressed areas. Since 1986, more than 200 such programs have been established, primarily at the state and local level. The success of these programs is measured not only in terms of the income generated and jobs created, but in the fact that their participants join the ranks of the self-employed and job providers. Many former welfare recipients are the beneficiaries of micro-enterprise programs.

SBA's micro-lending programs, which combine federal resources with those of nonprofit micro-lenders and local universities, have also been a success over the last several years. Thousands of new firms have been created, and the repayment record for both micro-loans (loans under \$100,000) and mini-loans (loans under \$25,000) has been satisfactory.

Since the 1995 White House Conference on Small Business, more than 3 million citizens have been removed from the welfare rolls and returned to the productive labor force. Small firms and

micro-lending programs, by offering welfare recipients alternatives, have played a major role in this process. One additional tool that small firms need in this process is access to more affordable, low-cost training programs.

Several participants in the White House Conference on Small Business focus group said that the government will soon have to deal with a new micro-business movement in the form of the fast-developing home-based business sector. Technology and the Internet are accelerating the growth of this sector, while government at all levels is trailing behind the trend. Local governments often try to limit the inevitable growth of home-based businesses through zoning regulations; the federal government does the same by limiting the deductibility of valid business expenses. At the federal level, at least, health care deductibility for the self-employed is increasing.

***Insight 18:
Youth entrepreneurship
represents our
hope for the future***

Entrepreneurship and small business ownership will continue to have the power to excite and motivate young people, including more and more new college graduates. The fundamental changes that have been occurring in the economy—for example, increasing independence as well as connectivity because of the Internet, other technological changes, better marketing of government programs, the lack of security in larger firms, and new wealth in the equity markets—are encouraging more young people (so-called generation X'ers) to pursue entrepreneurship.

Conclusion

The dynamic U.S. economy is reflected in its small business sector. Small firms continually start up, expand, and close at rapid rates in the United States. This phenomenon allows new ideas and processes into the economy, even as unproductive ideas and processes disappear. Revolutions occur at the firm level. Stability or cyclical growth characterizes the macroeconomic level.

Starting small has several advantages: a minimum amount of capital is required, and entrepreneurs have the opportunity to learn—and innovate—while the stakes are relatively small. One of the great strengths of the American system—rare today in the global economy—is the bankruptcy protection that allows creative Americans to try and try again. The economic renewal that results from this process of experimenting, making mistakes, and being able to start over with a better idea makes the U.S. economy the envy of today's world.

As entrepreneurs take advantage of new opportunities and new firms replace those that close, the net number of new small businesses will continue to grow, slowly but steadily. A few small businesses will become the mega-firms of the 21st century. Others will remain small, providing initial employment and training for a large share of the American work force. Because a relatively constant share of small businesses grow to be large, the small business share of employment and of the economy will not change much over time.

What is likely to change is how small businesses operate, what new industries they create and which industries disappear. Technology and population changes will be driving forces. The aging of the U.S. population means that companies will need to adjust to the changing makeup of their labor forces. Growing connectivity among all parts of an increasingly global economy will have long-term effects.

In short, if history is prologue, small businesses will continue to start up, grow, and innovate—not just as they are today, but as new and different entities.

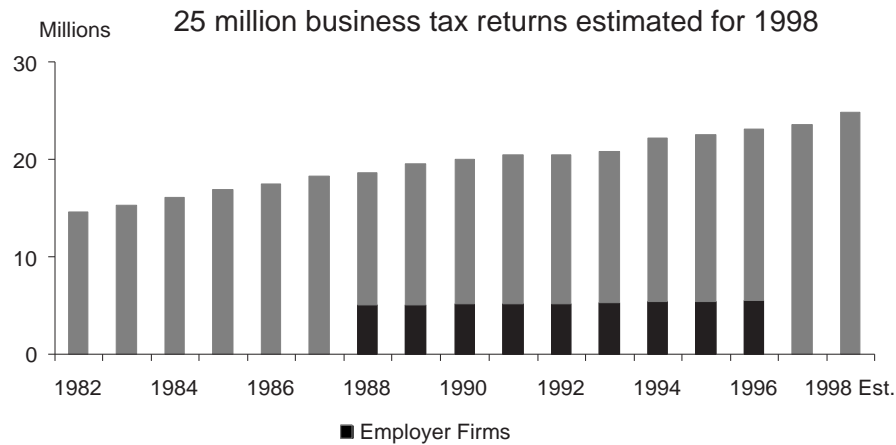
The Economic and Demographic Trends

On the following pages is a version of a presentation that has proven to be very popular with small business organizations around the country since its first publication in 1995 during the White House Conference on Small Business.

Entitled *Small Business in the Year 2005 and Beyond: The Economic and Demographic*

Trends, it represents a distillation by the Small Business Administration's Office of Advocacy of statistical findings and research from a wide variety of sources. The presentation gives a wide-ranging look at the most important trends that will affect small business over the coming decade.

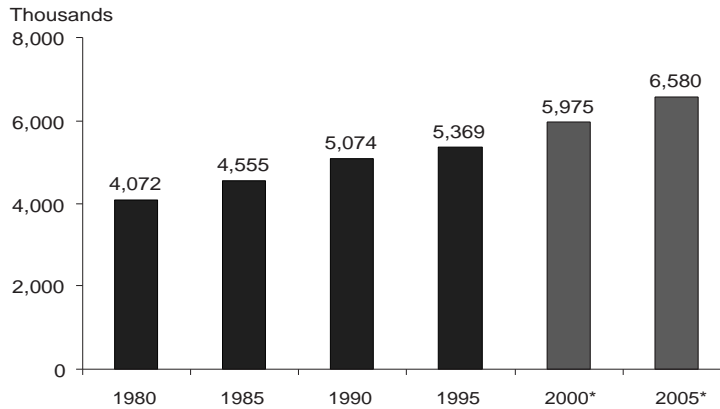
Business Tax Returns, 1982–1998



Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Internal Revenue Service and Bureau of Census, Statistics of U.S. Business.

- The Internal Revenue Service estimates that there were 24.8 million non-farm business tax returns filed in 1998.
- About 5.5 million of these business returns represented employer businesses. More than 99 percent of them were small companies with fewer than 500 employees.
- The number of tax returns has increased steadily over the last decade, with a decline in only one year. This trend is expected to continue.

Employer Firms, 1980–2005



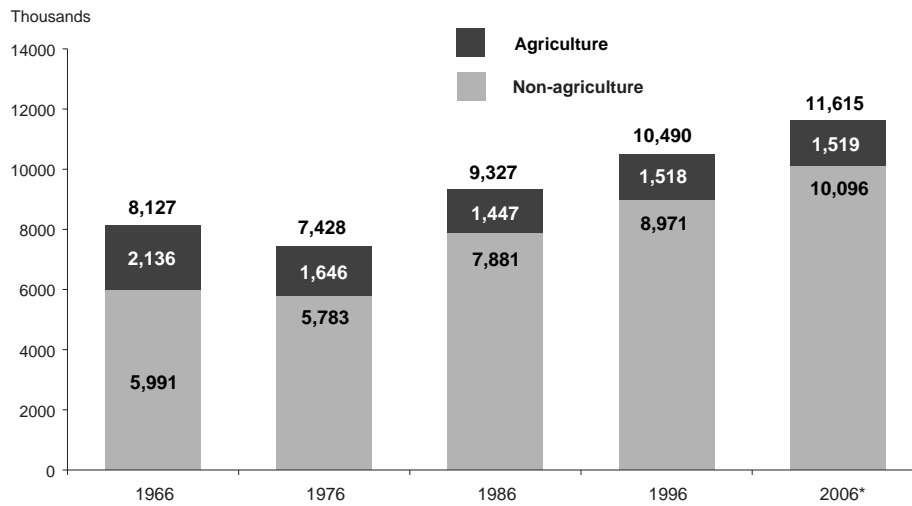
* = Estimates

Note: Data estimated from 1982–1988 Department of Labor data and 1989–1996 Bureau of the Census data. The rate of increase in new employer firms from 1982 to 1998 was used to both forecast subsequent years and impute data for prior years.

Source: Office of Advocacy, U.S. Small Business Administration from data provided by the Department of Labor, Employment and Training Administration, and Bureau of the Census, Statistics of U.S. Business.

- The number of employer businesses has increased by about 50 percent over the last two decades.
- The number of employer firms is expected to be nearly 6.6 million by 2000.

Self-Employment, 1966–2006



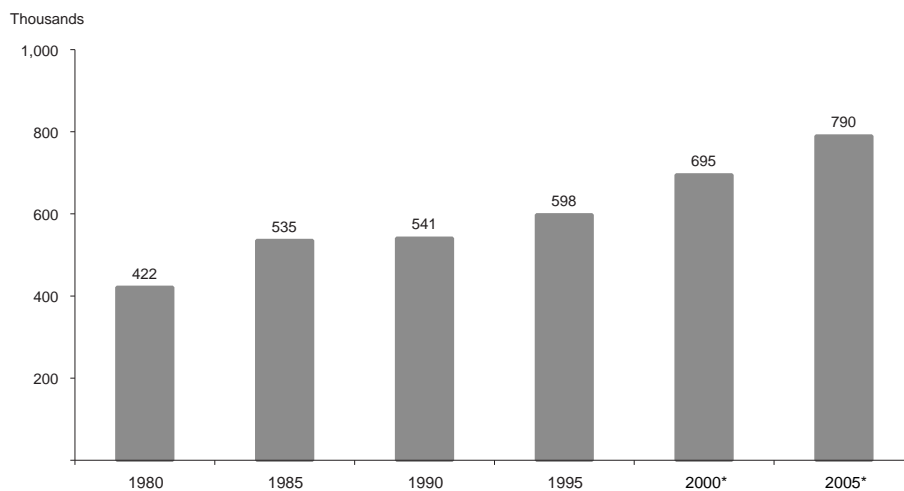
* = Estimate

Note: Self-employment is defined here as an individual's primary occupation.

Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Bureau of Labor Statistics.

- Employment declines in farming and manufacturing industries are expected to continue to free more individuals to pursue entrepreneurial activity.
- Entrepreneurship is also expected to grow because of continued corporate “right sizing” and mergers among large organizations.

New Employer Firms, 1980–2005



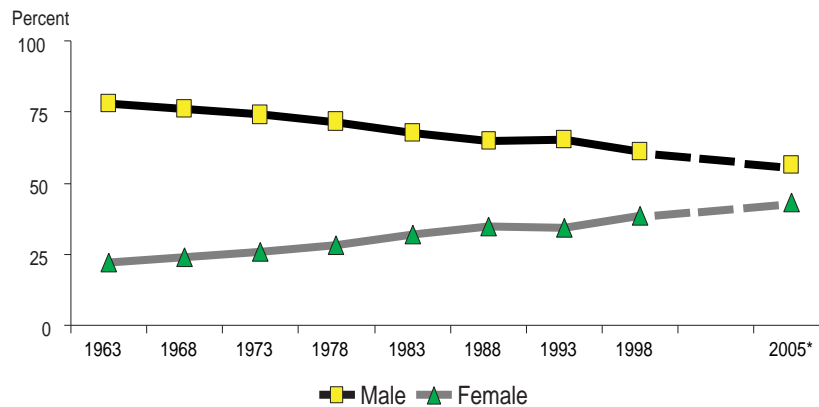
* = Estimates

Note: Data estimated from 1982–1988 Department of Labor data and 1989–1996 Bureau of the Census data. The rate of increase in new employer firms from 1982 to 1998 was used to both forecast subsequent years and impute data for prior years.

Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Department of Labor, Employment and Training Administration, and Bureau of the Census, Statistics of U.S. Business.

- The climate for new employer business formation has continued to improve.
- Almost 800,000 new employer firms are expected to be added by 2005. (This excludes secondary locations of pre-existing businesses.)

Share of Self-Employment by Gender, 1963–2005



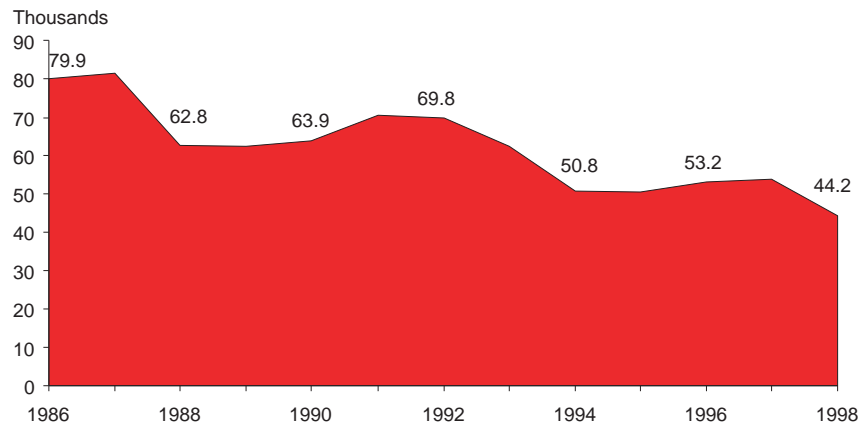
* = Estimate

Note: Self-employment is defined here as an individual's primary occupation.

Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Bureau of Labor Statistics.

- The number of “primary self-employed” individuals — that is, those whose main source of income was through self-employment — is expected to be 11.6 million in 2005. About 4.7 million of these individuals will be women.
- Women’s share of self-employment is expected to be about equal to that of men by 2005.
- Men are still more likely to be self-employed than women.

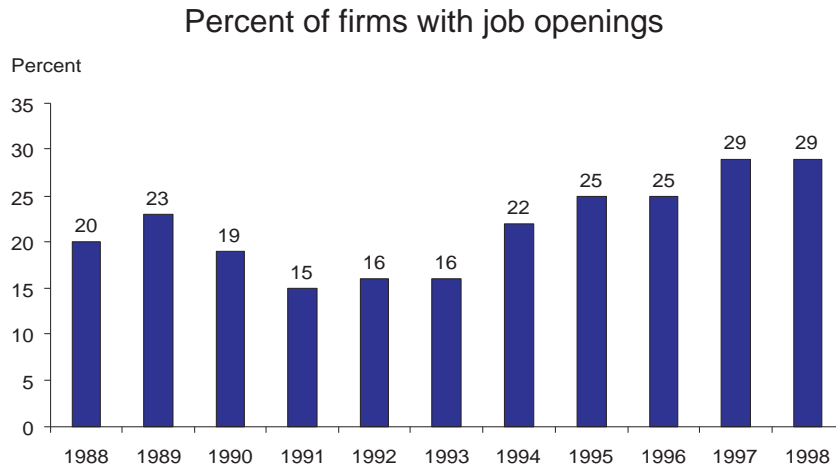
Business Bankruptcies, 1986–1998



Source: Office of Advocacy, U.S. Small Business Administration from data provided by the Administrative Office of the U.S. Courts.

- Business bankruptcies dropped from around 80,000 in 1986 to about 44,000 in 1998.
- The figures for 1998 marked a low in the number of business bankruptcies over the last dozen years.
- Bankruptcies increased only slightly during the last recession (1990–1992)

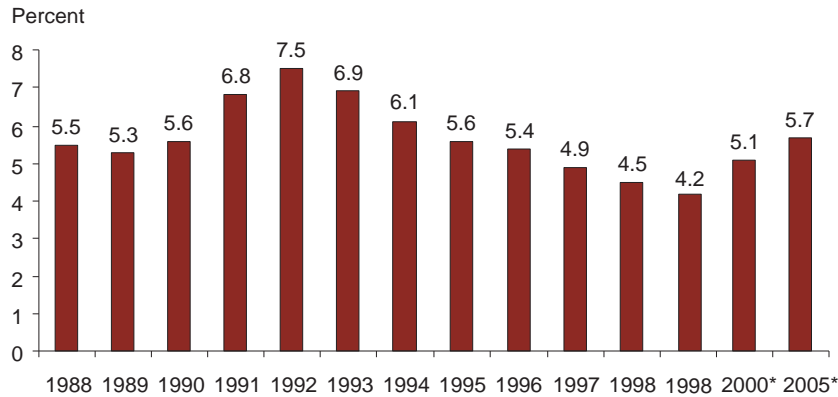
Labor Shortage, 1988–1998



Source: Office of Advocacy, U.S. Small Business Administration contract to Joel Popkin and Company using National Federation of Independent Business data.

- Almost one-third of firms belonging to small business associations had job openings in 1998 that they were unable to fill.
- One result of the continuing low unemployment rate is the highest percentage of businesses unable to fill current openings over the last decade.
- Only 15 percent of businesses had openings that they could not fill in 1991; this figure had nearly doubled by 1997.

Unemployment Rate, 1988–2005

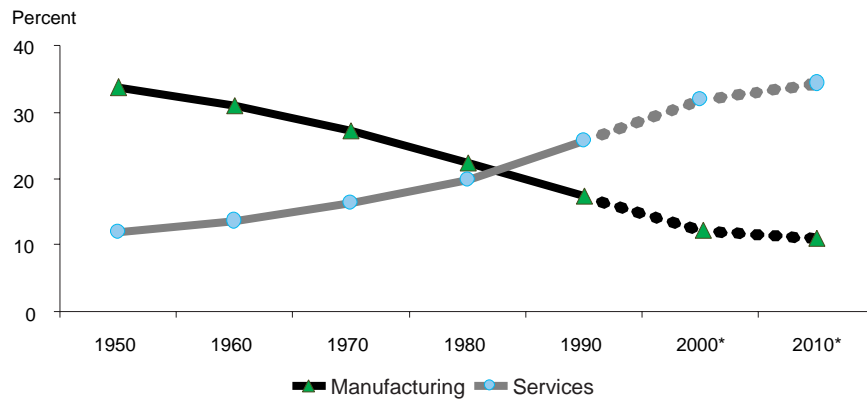


* = Estimates

Source: Office of Advocacy, U.S. Small Business Administration from data provided by the Bureau of Labor Statistics with projections from the Congressional Budget Office.

- The unemployment rate continues to fall. The 1998 rate of 4.5 percent is a full percentage point lower than the 5.5 percent posted a decade earlier.
- The 1998 unemployment rate is the lowest rate posted since 1969, when it was 3.5 percent.
- Economic conditions continue to portend a healthy economy, as the unemployment rate stays historically low.

Employment in Manufacturing and Services Sectors, 1950–2010

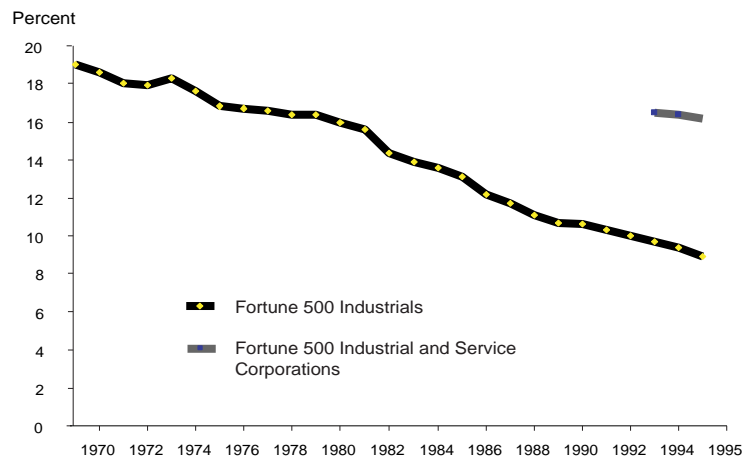


* = Estimates

Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Bureau of Labor Statistics and projections from Bureau of Economic Analysis.

- Similar to farming, as manufacturing productivity increased, employment in the manufacturing sector declined. Services picked up the employment slack with such thriving industries as health care and computers.
- The gap between employment in the manufacturing and service sectors is growing, and is expected to continue to increase over the next decade.
- By 2010, the relative shares of employment in the manufacturing and service sectors are expected to be just about the opposite of their 1950 levels.

Fortune 500 Share of Employment, 1969–1995

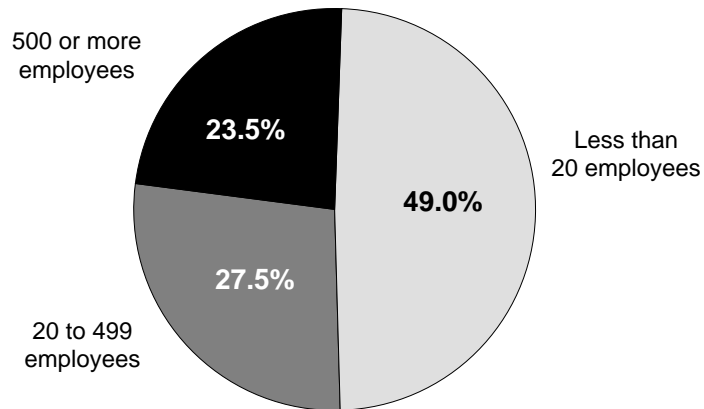


Note: In 1994, the Fortune 500 Industrials became the Fortune 500 Industrial and Service Corporations. 1995 500 Industrials was estimated from the Fortune 1000.

Source: Adapted by the Office of Advocacy, U.S. Small Business Administration, from data provided by the Fortune 500, and the Bureau of Labor Statistics, Department of Labor.

- The share of U.S. employment represented by the Fortune 500 Industrials continues to decline.
- In 1996, the Fortune 500 Industrials share of U.S. employment was nearly half of what it was 30 years ago.

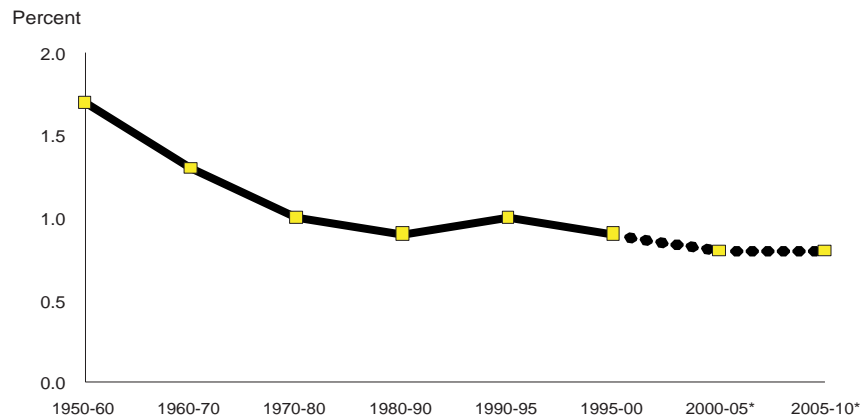
Share of Net New Jobs by Employment Size of Firm, 1990–1995



Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the U.S. Department of Commerce, Bureau of the Census.

- Small businesses have historically been the generators of the bulk of net new jobs in the U.S. economy. This is expected to continue into the future as new firms start small and grow.

U.S. Population Growth, 1950–2010

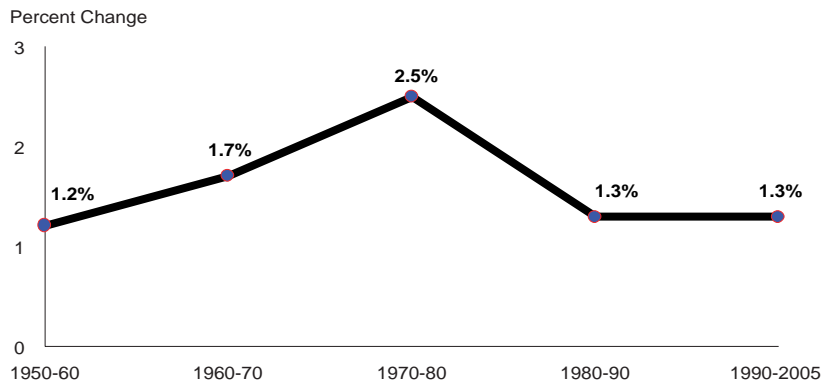


* = Estimates

Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Bureau of Economic Analysis.

- While the population of the United States will continue to increase in the future, it will increase at a much lower rate.
- The rate of population growth declined, decade by decade, from 1950 onward, except during the 1990–1995 period.

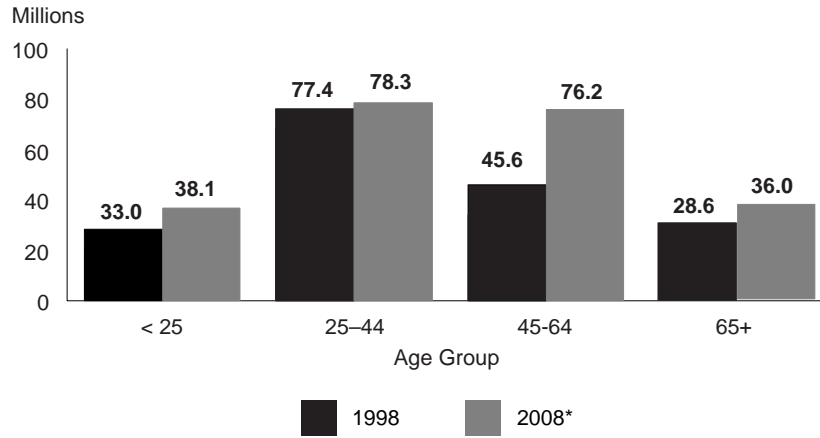
U.S. Labor Force Growth, 1950–2005



Source: Office of Advocacy, U.S. Small Business Administration from data provided by the Bureau of Labor Statistics.

- Rather than decline steadily (as population growth rates did) the labor force growth rate increased from 1950 to 1980, before beginning to decline in the 1980s.
- The driving forces of the continued increase were the “baby boom” children entering the labor force and increased participation in the labor force by women.
- The growth rate of the U.S. labor force is expected to remain steady through 2005 — at about 1.3 percent — driven by the growth of the minority work force and the declining birth rate experienced during the 1970s.

Labor Force by Age Group, 1988 and 2008

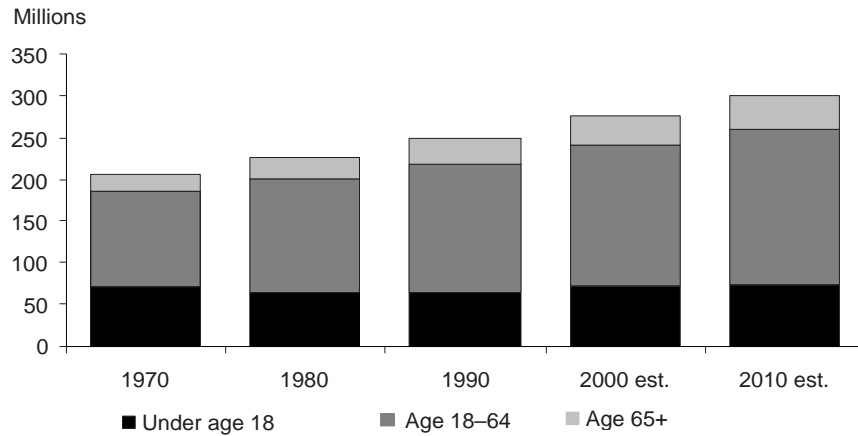


* = Estimate

Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Bureau of Labor Statistics.

- The average age of a worker will increase from 35.9 years in 1988 to 40.7 years in 2008.
- The number of workers aged 45–64 is expected to increase by over 30 million, or about two-thirds, from 1988 to 2008.

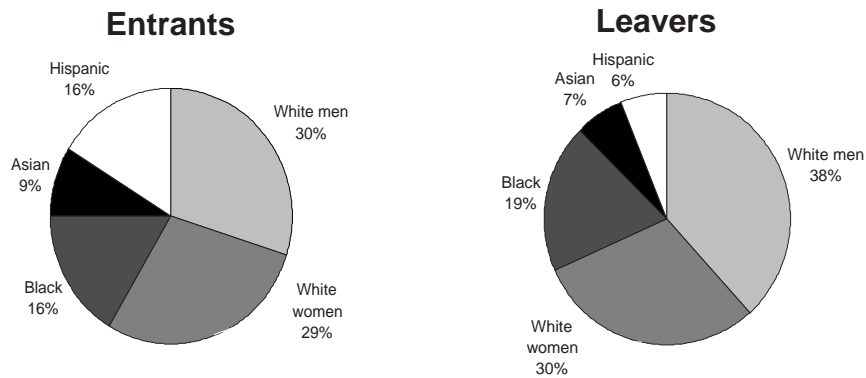
Population by Age, 1970–2010



Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Bureau of Economic Analysis.

- The 65-and-over age group has continued to increase its share of the U.S. population. This increase is expected to continue well into the next century.
- The 45–64 age group (not specifically shown in this chart) increased its share dramatically between 1980 and 1990.
- The share of the youngest group — those under 18 years of age — has fallen over the last several decades and is expected to remain relatively constant over the next two decades.

Labor Force Change, 1998–2008

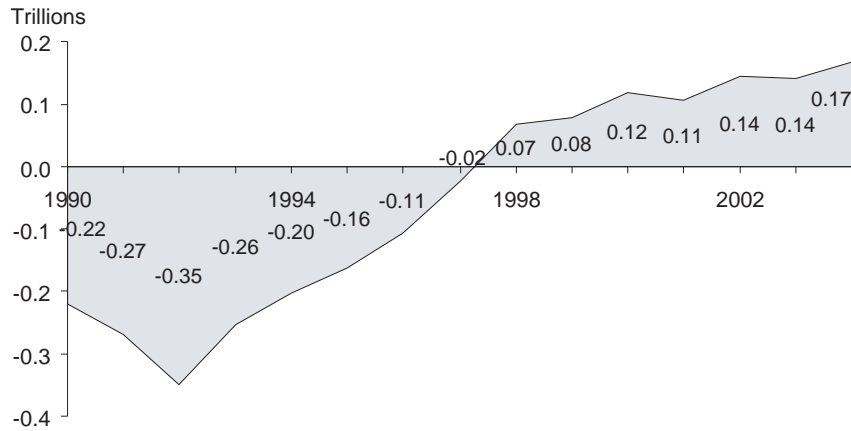


Note: Races do not include Hispanics. By gender, women represent an estimated 50.1 percent of the labor force entrants and 45.1 percent of the leavers during this time period.

Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Bureau of Labor Statistics.

- Women and minorities will be driving the net growth in the labor force over this time period.
- Women will represent about half of the entrants into the labor force during 1998–2008, and only 44 percent of those exiting.
- Hispanics will represent 16 percent of labor force entrants and just 6 percent of those exiting.
- White men will represent about a third of the entrants while representing nearly 40 percent of those exiting.

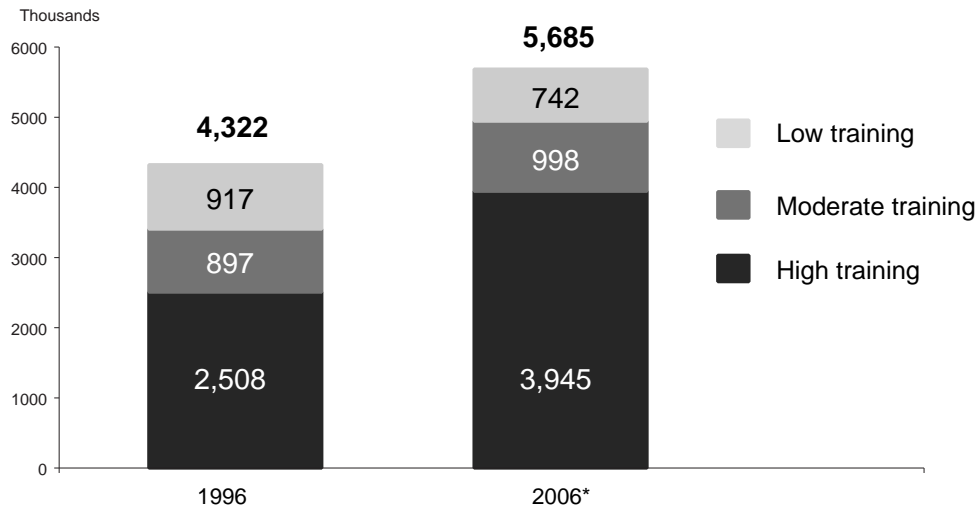
Government Deficit/Surplus, 1990–2004



Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Office of Management and Budget.

- Given current budget forecasts, the U.S. federal government surplus is expected to continue to grow into the beginning of the next century. (The calculations include the Social Security surplus.)
- While the federal government's budget surplus is expected to continue to grow into the 21st century, it will take awhile to recover from the deficit levels of the early 1990s.

Information Technology Employment, by Level of Training Required, 1996–2006



* = Estimates

Note: Includes information technology users and producers. Information technology producers are expected to increase from 1.45 million in 1996 to 2.24 million in 2006.

Source: Office of Advocacy, U.S. Small Business Administration, from data provided by the Department of Commerce (using Bureau of Labor Statistics data).

- Employment in the information technology sector is expected to increase by about a third from 1996 to 2006.
- Most of these increases are expected to be in occupations for which a high degree of skill or training is necessary.
- Based upon historical data collected by the Bureau of the Census, approximately two-thirds of new jobs in this sector are expected to come from companies with fewer than 500 employees