

SMALL BUSINESS \$ ENTREPRENEURSHIP

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Small business and entrepreneurship underpin American democracy. The freedom and opportunity to create a personal destiny represents a seminal value in the nation's economy and society. In America today, it is estimated that just over 10 percent of the workforce owns a business and 3.5 percent of the adult population starts a business each year.¹ The image of a young Michael Dell tinkering with computers in his university dorm room resonates in the American psyche. The entrepreneurial drive fuels the innovation and job creation that secures our country's economic future.

Discussions about economic growth often revolve around big companies and major industries. Yet the small business sector keeps our economic base diversified, generates risk-taking innovation, and accounts for much of the employment in America. Today 99.9 percent of U.S. businesses are considered small, defined as having fewer than 500 employees, and those small businesses employ 50.7 percent of the private-sector workforce.²

Excerpt from: *The NEXT American Opportunity: Good Policies for a Great America*

Small Business & Entrepreneurship | Overview

Small business in America remains true to its nature. The average small business has only one location and 10 employees. In fact, less than three percent of firms employ more than 50 people. These ventures also manage relatively small financial operations. More than 70 percent of firms have annual sales of less than \$500,000, and 80 percent have assets valued at less than \$500,000. Not surprisingly, 45 percent of small firms are sole proprietorships. Small size, however, has translated into large economic contributions. From 1990 to 2003, firms with fewer than 20 employees accounted for almost 80 percent of net new jobs in the United States.³

Ultimately, a mismatch exists between the current products offered by banks and the needs of many small businesses.

The entrepreneurial spirit continues to be strong. Self-employment rose 12.2 percent from 1995 to 2004.⁴ This drive to own a business exists across race, gender, and ethnic lines. For the past two decades, women-owned firms have grown at approximately double the rate of all firms. Minority women have particularly high rates of entrepreneurship. While 28 percent of white business owners are women, 31 percent of Asian American business owners and 46 percent of African American business owners are women.⁵

Immigrants in America join the long tradition of entrepreneurship on their arrival. The Kauffman Foundation estimates that just over four percent of immigrants started a new business in 2005, compared with just over three percent of native-born citizens.⁶ Many immigrant enclaves have also become centers for ethnic business districts. In New York City, for example, several neighborhoods boast clusters of retail firms that attract ethnic consumers from all over the tristate region. Many immigrants are seeking familiar products and the social networks that come from shopping and dining in neighborhood business districts.⁷

The contributions made by small businesses in America are impressive. Often surviving on a shoestring budget, these firms navigate small boats on an ocean of economic activity. The precarious nature of that position leads to a significant number of small business closings. It is estimated that for every 10 small businesses that start up in this country each year, approximately eight shut down.⁸

Today's global environment presents new challenges and opportunities for small businesses. To compete, they must improve their capabilities and address the primary factors that will allow them to grow and thrive.

Nurturing entrepreneurial spirit is paramount to our country's cultural values and economic future, yet it is equally important for us to ensure that small businesses are able to thrive and contribute to their potential. The essential contributions small businesses make to innovation, economic diversification, revitalization, and job creation can be amplified in a supportive environment.

This chapter discusses the primary factors necessary for small business to succeed and reviews policy directions that foster a strong environment for small business and entrepreneurship. The papers in the chapter provide details on small manufacturing firms and their unique issues, the cash flow problems faced by many small businesses, small business recovery in the wake of a disaster, microfinance, and the use of venture capital funds for equity investments in small business.

As a lead-in to the papers found in the chapter, this overview reviews some of the primary factors affecting small business, especially those in underserved areas, including access to capital, business sophistication, networks, quality jobs, and research and development. Additionally, the overview addresses the unique challenges to minority-owned firms and discusses some of the current federal policies, or recommended federal policies, which affect small business.

ABOUT MARGO WEISZ

Margo Weisz has served as Executive Director of PeopleFund since its infancy in 1995 and serves as a consultant on a variety of projects. She has served as a lecturer at the University of Texas Graduate School of Business, where she taught a class on community development and social enterprise. Among the numerous awards Ms. Weisz has received are the 2006 Profiles in Power award from the *Austin Business Journal* and the 2004 Ernst and Young Social Entrepreneur of the Year award, and she was named the Austinite of the Year at the Austin Under 40 Awards of 2003. She was also chosen as a 2003 Marshall Fellow and in that role traveled to Europe to discuss transatlantic relations. Ms. Weisz is the president of the board of PeopleTrust, is a member of several other boards, and served as the 2003 chair of Austin's Small Business Task Force.



ACCESS

to Capital

A primary hurdle business owners face is obtaining the required capital to start and expand their businesses. The vast majority of entrepreneurs rely on personal savings or investment from family and friends to capitalize their businesses. For many businesses, especially those located in lower-income communities, financing options are limited.

With low levels of personal savings, little equity to tap into, and debt payments going toward highly depreciable consumer goods, many small businesses are left with limited means to invest in their own businesses. Further, family and friends are likely to share a similar wealth position and therefore are unlikely sources of investment capital. For people already living on limited means without a strong safety net, entrepreneurship becomes a challenging, high-risk career option.

Despite the inherent challenges, however, many people do choose to go into business, often starting their ventures undercapitalized and on a minimal budget. By their nature, young small businesses, especially those operating in an area with little economic activity, pose substantial risk for traditional bank lenders. The start-ups may not be bankable because of insufficient equity, inadequate collateral, minor credit issues, or lack of historical cash flow. Coupled

with the fact that new small businesses typically do not have credit needs exceeding \$100,000, the small business profile does not fit in conventional banks' credit culture.

Ultimately, a mismatch exists between the current products offered by banks and the needs of many small businesses. Few banks consider business loans under \$100,000 a primary focus. Not only are the returns on \$50,000 less appealing than returns on \$5 million, but also, because of less-sophisticated financial reporting, small businesses can actually take more time to underwrite.

For those reasons, many large banks rely heavily on "credit scoring," which bases credit decisions exclusively on the quality of credit and net worth. Credit scoring is predictive rather than causal. Therefore, small business owners with little or no credit history can be downgraded. Again, for business owners operating in an underserved community, a downgrade can represent a significant barrier. Firms that have been able to start and initially expand on personal savings cannot show a credit history that would allow them to the access capital needed to compete in the economic mainstream.

Community development financial institutions (CDFIs) that provide business loans in underserved markets are ideal intermediaries between borrowers and standard financial institutions, providing businesses in lower-income communities with flexible capital and technical assistance designed to build clients' capacity to participate over time in conventional financial markets.

Successful business owners who mentor newer entrepreneurs play a decisive role in developing business sophistication.

Small businesses with high-growth potential seek equity. In addition, achieving high levels of innovation requires entrepreneurs to take substantial risk. But patient, higher-risk capital is scarce in low-income and minority communities. Capital is a basic input for business success; it is the horsepower needed to take on larger contracts, upgrade technology, purchase equipment, and invest in new products and services. Small businesses can only grow in an environment that provides appropriate capital sources for their needs.

BUSINESS Sophistication

Business sophistication allows savvy entrepreneurs to engage in strategic planning, employ new technology, build meaningful business relationships, and attract capital to their ventures. The effect of education on entrepreneurial activity is similar to that of household income. Those with more education are more likely to be involved in starting a business and leading it toward success.

Before discussing how other factors affect business sophistication, it is important to highlight the vital role that more equitable public education plays in any long-term strategy for improving business sophistication. A strong curriculum focusing on both financial and technological literacy is important for every child and critical to a business owner in today's

economy. Although a deeper discussion of public education is outside the scope of this chapter, its fundamental role in building business sophistication should not be ignored. Children from lower-income neighborhoods rely on the public school system for their education. Youth entrepreneurship translates into a host of useful skills and increases the chances that these children will grow up to start and successfully navigate through the challenges of business ownership.

Business sophistication entails more than the capacity to create and review financial reports. In short, it requires entrepreneurs to both understand and be able to apply fundamental business principles. It requires the ability to:

- Identify market opportunities and the financial wherewithal to capitalize on them;
- Recognize and track industry trends such that the business maintains its competitive advantages;
- Understand how to foster long-term business relationships with key partners and clients;
- Understand cultural barriers (e.g., culture of mainstream business); and
- Invest in quality, such as new technology, over the long term.

One of the primary ways new entrepreneurs learn the trade is through the ongoing advice of business role models. Successful business owners who mentor newer entrepreneurs play a decisive role in developing business sophistication. They share lessons learned, offer access to existing business networks, and sometimes even provide capital.

To compensate for the lack of comparable educational attainment and access to successful role models, many cities and initiatives have developed extensive training and mentoring programs for entrepreneurs. The mixed success of these programs highlights a third challenge for building sophistication. Many entrepreneurs of small firms do not recognize the full value of educational opportunities, both formal and informal. Small businesses with limited resources are hard pressed to attract well-educated employees and high-quality professional services. As a consequence,

the entrepreneurs themselves are forced to serve in numerous capacities, often doing the bookkeeping and marketing as well as providing services. They feel they have no time to take advantage of educational opportunities. Moreover, many have not had the role models or education that help them recognize the value of certain basic business principles, like using monthly financials to manage operations or reviewing industry trends to adjust a business model.

In today's current global economy, business owners face both increased opportunity and increased competition. Understanding the newest trends, employing effective technology, and using financial information to navigate through decision making are essential to survival and growth.

NETWORKS

Business networks are more prolific and more nuanced than ever before. Historically, business opportunities for small business were generated through local relationships. Today the local, regional, and global economy has the capacity to integrate the products and services of small firms into the supply chain. For the sophisticated entrepreneur with access to capital, the opportunities are immense.

Small businesses are successfully penetrating new markets; they account for 97 percent of all exporters and nearly a third of total export value. Mexico, Canada, and China are strong markets for U.S. small businesses.⁹ The global economy has brought significant gains in market opportunity and simultaneously new competition from foreign competitors able to hire low-wage workers. Additionally, participating in global markets includes both legal and cultural navigation. Many small businesses are ill equipped to understand the changing rules, and they do not have the resources to steer through the potential obstacles.

Small businesses that are prospering have the capacity to respond to major trends across the supply chain: locally, regionally, and globally. For small businesses in underserved communities, the ability to enter the supply chain is limited by both internal and external factors. Internally, many small firms lack the relationships, sophistication, or capital to compete effectively. Externally, larger institutions have centralized supplier practices, rely on preexisting relationships, and can require complicated legal contracts that hobble small businesses that are not equipped to recognize terms that put them at a disadvantage.

CGE Incorporated
Austin, Texas



“All I ask is to get my foot in the door” is a sentiment echoed across the country. Many entrepreneurs feel that if they were just given the opportunity, the rest would take care of itself. However, weak relationships primarily stem from issues specific to the nature of corporate procurement and the scale and sophistication of small firms. Corporate procurement practices have evolved over the last decade so as to raise the barriers to entry for small business. Many larger corporations have adopted the practice of strategic sourcing. Strategic sourcing is a procurement model that emphasizes the reduction of supplier firms; centralization of procurement activities; larger-sized contracts; and the use of fixed-price, fixed-outcome contracts. It is an alternative sourcing trend that does not bode well for most small businesses that are undercapitalized, technologically antiquated, and unfamiliar with the protocols of the existing supplier networks.

Further, the negative effects of the sourcing trend are exacerbated by procurement processes that do not prioritize supplier diversity in their institutionalized practices. Although corporate management might accept and communicate the importance of supplier diversity throughout the company, that has not translated into quantifiable results. Absent explicit accountability metrics, the power of incumbency and existing relationships have precluded many small firms from receiving fair consideration for new business opportunities.

Lack of scalability and business sophistication also play a central role in explaining small and minority firms’ inability to develop stronger relationships with larger corporations. As a whole, those firms often are not at a scale to compete effectively for many of the business opportunities at larger corporations. They cannot compete on price per unit, do not have sufficient capitalization, and cannot weather the inevitable vicissitudes of working with customers who largely dictate the terms of doing business. Compounding the limited scalability is the fact that many small business owners lack the requisite business sophistication to appropriately manage and build the necessary business relationships.

QUALITY JOBS

Perhaps the most pressing question for businesses operating in today’s economy is, “How will we attract and keep skilled workers?” For small business owners, that question poses distinct and considerable challenges. Healthcare and retirement plans in America are tied closely to employment, and for most small firms, the costs of offering those basic benefits are prohibitive. Additionally, with higher rates of closure compared with large firms, small businesses are widely perceived as providing inferior job stability.

Individuals in America rely on their employment to provide access to adequate and affordable healthcare for themselves and their families. For small businesses, the cost of offering employer-provided health insurance has skyrocketed: between 2000 and 2006, health insurance premiums rose 78 percent. The soaring cost of health insurance has had a disproportionate impact on small businesses. The rate of annual increases in premiums for small businesses has been larger than that of their larger corporate competitors. Employees in the nation’s smallest firms pay, on average, 18 percent more in health insurance premiums than the largest firms pay for the same benefits.¹⁰

The escalation of healthcare costs has made employee health insurance an untenable expense for most small businesses. According to the National Federation of Independent Business, rising healthcare costs are the most important problem that small businesses face. More than 65 percent of small business owners ranked it as a critical issue. As a result, less than half of all firms with three to nine workers offer health benefits compared with 98 percent of firms with 200 or more employees.¹¹

For many workers or would-be entrepreneurs, personally assuming the cost of healthcare coverage is a significant deterrent from taking a job with or starting a small business. The unreliable trends in healthcare coverage and costs are another disincentive for workers to move to the small business sector.

Retirement benefits in America are also tied to employment. Pension plans are quickly disappearing from the private sector and being replaced by employer-sponsored 401(k) plans that offer matches to employee savings. The cost of offering retirement benefits is difficult for small businesses. According to a report by the U.S. Small Business Administration's Office of Advocacy, compared with their largest counterparts, the smallest firms pay as much as 14 times more in administrative costs for each participant in defined contribution pension plans, such as 401(k)s.¹²

The costs of these worker benefits put small businesses at a distinct disadvantage when competing with larger firms for talented employees. Although many small businesses may be able to keep workers through flexibility and loyalty, they are saddled with the perception of providing less job stability and fewer benefits. Taken together, these factors make it difficult for small businesses to compete because the playing field, in perhaps the most critical area, is not equal.

RESEARCH

and Development

Innovation is America's ticket to economic prominence. Meeting the challenges of tomorrow will depend on the ingenuity of our entrepreneurs. Small businesses are nimble and risk taking, and have always been at the forefront of innovation.

Research and development, a primary component of innovation, can be expensive for small businesses. Tapping into the potential of entrepreneurs requires a source of support for developing and trying new products in the market. Some states have designated significant funds for research in either specific industry focus areas or cluster development.

Cluster development takes the benefits of small business innovation to a higher level. Regions with successful clusters enjoy higher average wages, productivity, rates of business formation, and innovation. Economic clusters are formed through the organized development of innovation in complementary industries. Clusters are composed of a complementary network of suppliers, service firms, academic institutions, and organizations that together bring a set of products or services to market.

CDFI SUCCESS STORY

PeopleFund

CGE Incorporated
Austin, Texas

For 15 years, Carlos Esteves managed construction projects for two companies in Austin's semiconductor industry. When the industry faltered and he was laid off, he started his own general construction company, CGE Incorporated.

Although CGE soon attracted a lot of business, it faced a major challenge. Like any construction company, CGE needed funds to pay for materials and other up-front costs its jobs required. But as a new business, CGE had not established credit with its suppliers and could not get financing from a traditional lender. "We tried several banks, and they wouldn't give us the time of day," Mr. Esteves says.

But there was one lender in Austin that would listen to Mr. Esteves—PeopleFund.

Launched in 1994, PeopleFund promotes lasting economic vitality in low-income and minority communities by providing financing and training to ventures that will create jobs and safe, affordable housing. Originally created to serve the city of Austin, the organization has expanded to reach a five-county region in central Texas. It has made more than 265 loans totaling almost \$16 million to small businesses, schools, healthcare providers, and affordable housing developers.

PeopleFund gave Mr. Esteves a \$40,000 loan for working capital and helped him to develop a business plan and organize the financial side of his business. "They helped me put everything in order," Mr. Esteves says. "All the things you do when you start up a business and you want a loan, they walked me through."

Today, thanks to PeopleFund's financing and Mr. Esteves' skill and hard work, CGE is thriving. In 2007, annual revenue reached \$2.2 million, up from \$70,000 in 2002. And Carlos has found that traditional lenders are more willing to listen to him. Indeed, after building up his business and establishing a strong credit record with his PeopleFund loan, he applied for—and received—a line of credit for CGE from a local bank.

MINORITY- OWNED

Businesses

Minority-owned businesses often face a set of challenges compounding the other trials of small businesses. For minority-owned firms, access to capital is especially challenging because they possess a disproportionately small share of the country's wealth. According to a 2001 Consumer Confidence Survey,¹³ only 47 percent of nonwhite families had personal savings compared with 63 percent of white families. The minority families that had savings accumulated, on average, \$36,000 less than did white families with savings. In addition, nonwhite families were twice as likely to have a negative net worth as white families; the median net worth was \$17,100 for minorities versus \$121,000 for whites. A major cause of that disparity was the lower level of homeownership among minorities. Minority families' major assets tend to be their vehicles rather than their homes. As a result, they have lower levels of home-secured debt but higher levels of installment and credit card debt.

A 2007 study by the Kauffman Foundation shows that African Americans are 50 percent more likely to engage in start-up business activities than are whites.

Entrepreneurial activity is also robust in minority populations. A 2007 study by the Kauffman Foundation shows that African Americans are 50 percent more likely to engage in start-up activities than are whites. Hispanic men are slightly more likely than white men to be involved with a start-up business. The disparity is even greater for minorities with graduate degrees.¹⁴ Educated African American and Hispanic adults show especially strong entrepreneurial inclinations.

Despite a strong entrepreneurial spirit, however, minority populations lag far behind whites in both the proportion of firms owned and the size of those businesses. In 2004, whites constituted 88.3 percent of self-employed Americans.¹⁵ Additionally, studies show that minority-owned firms account for a larger

percentage of low-growth businesses. Employment in low-growth firms represents 30 percent in minority-owned firms and only 17 percent in nonminority-owned firms. That disparity is especially troubling because minority firms are more likely to hire minority employees. The number of large businesses owned by minorities also lags dismally behind. A Kauffman Foundation study estimates that 82 percent of minority-owned businesses are sole proprietorships, and only 20 to 25 minority-owned businesses in the country have revenues exceeding \$500 million.¹⁶

As stated previously, many large banks rely heavily on credit scoring. That often works to the disadvantage of minority entrepreneurs, who may possess minor credit blemishes because of their wealth position and often have a lower net worth. Over the last decade, industry consolidation in banking has resulted in an increased dependence on credit scoring and other lending practices that are more standardized. Even minority business owners with viable business ventures can find it difficult to fit into banks' credit culture.

Education significantly predicts nascent entrepreneurship, particularly for African Americans and Hispanics. Among men with graduate education experience, approximately 26 percent of African Americans and 20 percent of Hispanics report efforts to start a new business. By comparison, 10 percent of white men who attended graduate schools attempt start-ups.¹⁷

Minority entrepreneurs also have a circumscribed range of mentoring options. National business demographic data are instructive in explaining why that limitation exists. First, the number of minority entrepreneurs is far below that of nonminority entrepreneurs, both in absolute terms and proportionally. Second, even fewer minority firms are of notable scale (e.g., greater than \$5 million in annual revenues). Those facts suggest that minority entrepreneurs have not only few potential mentors to choose from given the nature of business segregation but also few successful role models from whom they can learn to grow their businesses. Consequently, building business sophistication is more challenging for minority entrepreneurs because they lack

comparable access to successful role models and mentors relative to their nonminority counterparts.

Collectively, the factors discussed here tend to marginalize minority business owners. Acting as both a cause and an effect, business segregation further weakens minorities' business networks. Given their lack of access to corporate networks, minority business owners conduct business with one another, forming their own small networks. However, those isolated networks do not possess sufficient economic activity on their own to provide growth opportunities. Social contacts formed outside business networks are another primary tool for creating business relationships, but social segregation limits their value as well. Together, business and social segregation mitigate the value of minorities' business networks and increase the difficulty of accessing corporate networks.

POLICY Directions

Good policy, at both the state and federal level, ensures that our market economy fulfills democratic values and a robust economic vision. Policy can provide a fertile environment for innovation and growth to take root. Because this book focuses on federal policy, state issues will not be discussed except in the context of working with the federal government. However, it should be noted that states play a vital role in helping small business flourish and prosper.¹⁸

Federal policy has addressed access to capital for small business through various mechanisms, including the Community Reinvestment Act (CRA), the programs housed at the U.S. Treasury Department's Community Development Financial Institutions Fund (CDFI Fund), and the Microloan Program and other mechanisms provided by the U.S. Small Business Administration (SBA). All these programs have met with some success and have begun to open new sources of capital for small business. To reach their full potential, the programs will need to address issues of scale, scope, sustainability, and effectiveness.

Although many of the following topics are discussed in more detail in other chapters of this book, they are emphasized here for their role in small business.

Community Reinvestment Act. CRA requires the regulatory process to compel every bank to respond to the credit needs of its local community. Studies have shown that CRA has helped to spur \$1 trillion in home mortgage, small business, and community development lending to low- and moderate-income communities.¹⁹ However, most of those gains, while significant, are in the housing sector, where CRA enforcement has been strongest. Small businesses in low-income markets remain underserved.

A strong CRA with delineated performance measures can be a powerful tool to open up credit opportunities for small business. As discussed earlier, most small businesses are starting to use alternative sources of financing. That opens up a tremendous opportunity to expand CRA to nondepository institutions that provide financial services.

CDFI Fund. The U.S. Treasury Department's CDFI Fund expands the capacity of CDFIs to provide credit, capital, and financial services to underserved populations and communities in the United States. CDFI Fund programs, as well as many state and local initiatives that focus on low-income and minority communities, play a critical role in building credit capacity. For small business lending, where the service gap is both complicated and pronounced, the CDFI Fund's technical assistance and financial assistance grants are essential for both innovation and service provision.

Because those programs relate to small business, building the capacity of a specialized sector to serve low- and moderate-income communities and minority entrepreneurs will ensure that pioneering product development continues to be incubated and transitioned into the economic mainstream.

U.S. Small Business Administration. The SBA was created to better serve the credit needs of small businesses. Research has indicated that small businesses are challenged by insufficient capital during growth cycles. To meet that need, Congress created the 7(a) Loan Guaranty Program, which currently provides 30 percent of all long-term, small business

financing.²⁰ The widespread success of the program speaks to the key value of public-private partnerships.

However, the 7(a) Loan Guaranty Program is becoming an expensive and untenable option for many small businesses. Since 2005, four consecutive fee increases have shifted the complete cost of the program to small businesses and their community lenders. For small and midsize loans, fees were raised by approximately \$1,500 to \$3,000, and for larger loans the fee can now exceed \$50,000. The higher fees have significantly reduced small business lending across the country. Small firms received \$160 million less through the 7(a) Loan Guaranty Program in the first six months of fiscal year 2006 than during the same period of the previous year.²¹

Federal capital access program. Loan loss reserve programs, or capital access programs (CAPs) are some of the most cost-effective programs for improving capital availability for small business. A loan loss reserve provides an incentive (via a credit enhancement) to lenders to make loans to small businesses. A CAP contributes funds into an account for small business loans with certain risk characteristics. Funds contributed usually range from two percent to eight percent of the principal. The funds are combined and leveraged against capital deposited into the account by both the lender and the borrower. As loans are enrolled in the CAP, the balance in the account increases and thus spreads the

risk over many loans. Should an enrolled loan default, the lender can draw on the account to replenish the lost capital.

A CAP is easy to operate, and because dollars are permanently expensed into a loan loss reserve fund, it does not require extensive servicing. The enrolled lenders do most of the work by doing the loan underwriting. CAPs have been used at both the state and local level. However, with the consolidation of the banking industry, banks are finding it increasingly difficult to tailor underwriting to local products. A federal CAP was authorized when the CDFI Fund was created, but it has never received appropriations. Funding for a federal CAP would allow banks and other lenders to develop products tailored to meet the goals of the program.

Individual development accounts. Most small businesses use savings or investments from friends and family to start and expand their businesses in the early stages. Encouraging savings through policy is a key component of financial stability and allows individuals to more easily start entrepreneurial ventures.

The most common tool used to encourage savings is the individual development account (IDA). An IDA provides a dollar-for-dollar match for a person who contributes to a restricted savings account. The



IDA can be used for designated purposes such as purchasing a home or starting a small business.

A preponderance of research has indicated that building personal assets is a more effective key to opportunity than a sole focus on increased income. IDAs are a valuable tool for providing a needed source of equity capital to small businesses. Additionally, for entrepreneurs that spend their lives living off the income from their ventures, a savings program allows them a critical source of funds for retirement.

Trade policies. Business success is predicated by an entrepreneur's ability to enter supply chains. As discussed, the global economy offers vast opportunities for small business. The obstacles to benefiting from expanded markets relate to the internal resources small firms have in place to understand inconsistent trade provisions. Small businesses have much to gain from trade policies that establish a clear rules-based system, nondiscriminatory standards, and predictable customs procedures. To compete effectively in foreign markets, small businesses can benefit significantly from the development and enforcement of fair, transparent, and predictable trade policies.

Healthcare. Tying health insurance to employment has proven problematic for both workers and small firms. Many small firms, unable to shoulder the costs of insuring employees, are constrained in hiring and retaining high-quality workers. Ideally, health insurance would be disconnected from employment, thereby leveling the playing field for employers and ensuring that a higher percentage of people are covered.

Other policy directions regarding health insurance should include publicly sponsored "buy-in" programs for small businesses. In 2006, Rhode Island started a \$100 million fund for small businesses to purchase affordable health insurance for their employees. The fund was created from securitized tobacco payments that create a perpetual revenue source. Montana created a similar program in 2005 that created a public-private partnership between Blue Shield and Insure Montana. These large pools allow for risk sharing and create enough volume to offer negotiating leverage with insurance companies.

Currently, more than 40 large U.S. employers, including IBM, McDonald's, and General Electric, have created a plan to create a nationwide insurance pool for part-time employees, subcontractors, and consultants. The plan calls for the companies to leverage their buying power to reduce the cost of coverage and help extend health insurance to millions of uninsured workers. The strategy will pool vendors, part-time employees, consultants, and retirees in a single group and seek bids from health plans for lower-cost coverage. Implementation of the plan is beginning in Dallas, Chicago, New York, and Los Angeles.

State incentives. States should play a dominant role in furthering policy to create a fertile small business environment. With state laws and funding sources varying to a significant degree, it makes sense for states to craft tools that complement their individual situations. Therefore, federal policy should provide state incentives to develop small business programs that are performance based. Federal incentives to encourage states to develop tools for small business growth would provide an effective means for infusing needed resources into small business development.

CONCLUSION

America prospers as its small businesses prosper. Nurturing entrepreneurial spirit is paramount to our country's cultural values and economic future. Today's global environment presents new challenges and opportunities for small business. To compete, they must improve their capabilities and address the primary factors that will allow them to grow and thrive. The following papers highlight the role CDFIs play in providing valuable resources to ensure the essential contributions small businesses make to innovation, economic diversification, revitalization, and job creation in our society. ■■

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