

The Small Business Economy: A Report to the President

U.S. Small Business Administration, Office of Advocacy, July 2009 [164 pages]

Purpose and Scope

In the 2009 edition of *The Small Business Economy*, the Office of Advocacy reviews the overall economic environment for small businesses in the year 2008, including brief subsections on small business challenges such as job creation and innovation, globalization, and competing for federal procurement dollars. The second chapter looks at the financial marketplace for small firms as the crisis in financial markets deepened in late 2008. Appendices provide additional data and a summary of new research in 2008 from the Office of Advocacy.

Highlights

The Small Business Economy in 2008

Small businesses, like the rest of the economy in 2008, were affected by the deepening recession, particularly in the fourth quarter. Real gross domestic product saw a 1.1 percent gain for the year, but fourth quarter GDP was down 6.3 percent on an annualized basis. If the past is an indication, the report suggests, small businesses will be leaders in the economic recovery.

- Small businesses in most industries, especially in the construction industry hard hit by the housing market downturn, saw declines in employment.
- Average unincorporated self-employment fell from 10.4 million in 2007 to 10.1 million in 2008 and averaged 9.6 million by November and December 2008.
- Incorporated self-employment remained steady at 5.8 million on average over the 2007-2008 period.
- Some surveys found small firms expressing less willingness to expand, hire new workers, invest in new plant and equipment, or borrow money, at least in the near term.
- As the new year began, the Obama Administration sought to counter falling aggregate demand through a stimulus package that invested in infrastructure development, educational facility improvements, broadband access, scientific research, and tax incentives.
- Health care costs remain a major concern for small firms. According to the Kaiser Family Foundation, the average annual cost of a family premium for employer-sponsored health insurance increased 119 percent between 1999 and 2008, with a 5 percent increase in 2008 from the previous year.
- Small businesses face difficult competition in offering benefits to their employees, and the result is greater turnover; the provision of benefits increases the probability of an employee staying another year by 13.9 percent.
- Demographic trends, including the retirement of the Baby Boomers in coming years, may exacerbate the challenges small businesses face in employee recruitment and retention.
- Global competition continues to be a challenge for firms of all sizes, but exports have been a bright spot in recent years. Real exports have risen steadily since 2005, outpacing the growth in imports; the value of real exports increased 6.2 percent in 2008.
- Small businesses obtained \$83.3 billion in direct prime federal government procurement in FY 2007, the most recent year for which data are available.
- It will be important for small firms to pay careful attention to the latest changes in procurement regulations, many of which, for example, will require “flowdown” compliance from subcontractors.
- Research documents small firms’ important contributions to innovation and job creation.

Small Business Financing in 2008

- The credit market freeze that occurred in September 2008 had a severe impact on the United States and the world economy.
- The financial markets struggled, but failed to gain the confidence of market participants sufficient to restore market functioning in 2008, despite extraordinary efforts by the Treasury Department and the Federal Reserve.
- Total business borrowing decreased from \$1.228 trillion in 2007 to \$507 billion in 2008.
- Business borrowing dropped in the fourth quarter of 2008 to a low annual rate comparable to the levels experienced in the 2001 recession, according to Federal Reserve Flow of Funds data.
- Most small businesses faced a less accommodating credit market, especially in the second half of 2008.
- Lenders exhibited widening interest rate spreads and tightening terms of lending.
- According to June 2007-June 2008 Call Report data, developments in the financial markets had a limited impact on small business lending in the first half of 2008.
- Despite the lack of very current financial data, a number of indicators suggest that funding to small firms was much curtailed by the end of 2008.
- New research using the Survey of Small Business Finances looks at small business financial patterns, the link between finance and small firm growth, and who is able to obtain credit.

Summary of Advocacy Research, 2008

The Office of Advocacy published more than 25 research studies in 2008, on topics in the fields of finance, energy, entrepreneurship, human capital and employee benefits, international trade, innovation and technology, owner demographics, procurement, regional economic development, regulation, and taxation. Sampled below are just a few of the studies summarized in Appendix B. Visit the summary to review all of the reports, which are available on the Office of Advocacy website at www.sba.gov/advo.

- *Characterization and Analysis of Small Business Energy Costs* finds that small entities in manufacturing and construction pay more for most, but not all fuels, leading to some competitive disadvantages, particularly in manufacturing.
- *High-impact Firms: Gazelles Revisited* finds that high-impact firms, defined by significant revenue growth as well as expanding employment,

are relatively old (25 years old on average) and rare (representing 2-3 percent of all firms), and contribute to the majority of overall economic growth.

- *Changes in Family Health Insurance Coverage for Small and Large Firm Workers and Dependents* finds that family health insurance coverage for workers in both large and small firms is decreasing, and that firm size plays a role in types of dependent coverage available for children.
- *The Impact of International Competition on Small-firm Exit in U.S. Manufacturing* finds that increased international pressure in the form of currency exchange rates leads to increased exit rates among very small manufacturers.
- Findings from *Entrepreneurship and the Barrier to Exit: How Does a Bankruptcy-friendly Law Affect Entrepreneurship Development at a Societal Level?* suggest that a society not willing to absorb the pain of having a large number of entrepreneurial failures, via an entrepreneur-friendly bankruptcy law, is not likely to reap the gain of vibrant entrepreneurship development and economic growth.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at www.sba.gov/advo/research. Copies are available for purchase from:

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