

Congress of the United States

U.S. House of Representatives

Committee on Small Business

2361 Rayburn House Office Building

Washington, DC 20515-6515

To: Members, House Committee on Small Business
From: Committee Staff
Date: July 20, 2012
Re: Full Committee Hearing: *“Tales of Resilience: Small Business Survival in the Recession”*

I. Hearing Overview

On Wednesday, July 25, 2012, at 1:00 pm in Room 2360 of the Rayburn House Office Building, the Committee on Small Business will meet for the purpose of receiving testimony to examine how, despite the harrowing recession and tough economy, some small business owners have grown by innovating and strategically adapting their business models in order to find success. The hearing will focus on how certain small firms overcame obstacles created or exacerbated by the economic climate. Further, it will examine methods utilized and cultivated by a portion of small businesses to achieve prosperity, such as: reducing costs, diversifying portfolios, capitalizing on emerging industries, and fostering innovation.

II. Economic Effects of the Great Recession on Small Business

According to economists, the United States experienced an economic recession from December 2007 through June 2009.¹ This recession, often referred to as the “Great Recession,” lasted 18 months and was the longest recession experienced in the United States since World War II.² The resulting stagnant economy has crippled employment, resulting in unemployment levels over 8 percent since February 2009, including a paralyzing 10 percent unemployment rate in October 2009.³

Small firms were hit particularly hard during the recent economic recession.⁴ For example, while overall employment decreased 8.4 percent, small businesses with fewer than 50 employees felt the brunt as jobs declined 10.4 percent.⁵ The force of this recession was

¹ NATIONAL BUREAU OF ECONOMIC RESEARCH, BUSINESS CYCLE DATING COMMITTEE REPORT 1 (Sept. 2010) available at <http://www.nber.org/cycles/sept2010.pdf>. It is important to note this organization is not affiliated with the federal government.

² *Id.*

³ BUREAU OF LABOR AND STATISTICS, LABOR FORCE STATISTICS FROM THE CURRENT POPULATION SURVEY (July 2012), available at <http://data.bls.gov/timeseries/LNS14000000>.

⁴ SAHIN, KITAO, CORORATON, & LAIU, FEDERAL RESERVE BANK OF NEW YORK, WHY SMALL BUSINESSES WERE HIT HARDER BY THE RECESSION, in 17 CURRENT ISSUES IN ECONOMICS AND FINANCE, VOL. 4, at 1, available at http://www.newyorkfed.org/research/current_issues/ci17-4.pdf.

⁵ *Id.*

particularly unique, as “40 percent of the overall employment decline can be attributed to losses at small businesses, compared with just 10 percent in the 2001 episode.”⁶

As small firms coped with the worst of the recession, these same firms were also highlighted by policymakers as key to the recovery. Healthy small businesses offer the way to reduce unemployment and restart growth in the American economy. Traditionally, small businesses have driven private sector employment, accounting for approximately 65 percent of net new job creation.⁷ This trend appears consistent following the Great Recession, with small businesses responsible for “slightly more than half of the net job gains in the private sector economy” since March 2010.⁸

However, small business optimism has remained low, declining 3 points in June 2012 to 91.4%, which is the lowest level since October 2011.⁹ One of the reasons for declining levels of small business optimism is economic uncertainty, which remains a top concern for small business owners.¹⁰ Notably, a recent survey found that 71 percent of small business owners still believe that the United States is in a recession.¹¹ While this is down from 2011, confidence in the economy remains weak among small firms, as 85 percent believe the economy will be in a recession in 2013.¹² This concern is exacerbated by declining increases in real gross domestic product (GDP),¹³ and morose consumer confidence, which in June 2012 hit a 5-month low, falling to 84.6.¹⁴

III. Types of Economic Growth

Despite these troubling statistics and real economic concerns, certain industries have been successful and some small businesses have managed to navigate the murky economic waters to find success and propel economic growth. Economic growth generally occurs in two ways;

⁶ *Id.* at 3.

⁷ BRIAN HEADD, OFFICE OF ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION, AN ANALYSIS OF SMALL BUSINESS AND JOBS 10 (Mar. 2010) *available at* <http://www.sba.gov/sites/default/files/files/an%20analysis%20of%20small%20business%20and%20jobs%281%29.pdf>; *See also* OFFICE OF ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION, FREQUENTLY ASKED QUESTIONS (Jan. 2011) *available at* <http://www.sba.gov/sites/default/files/sbfaq.pdf>.

⁸ KATHRYN KOBE, OFFICE OF ADVOCACY, UNITED STATES SMALL BUSINESS ADMINISTRATION, SMALL BUSINESS GDP: UPDATE 2002-2010 4 (Jan. 2012) *available at* http://www.sba.gov/sites/default/files/rs390tot_1.pdf, pg. 4

⁹ WILLIAM C. DUNKELBERG AND HOLLY WADE, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, NFIB SMALL BUSINESS ECONOMIC TRENDS 1 (July 2012) *available at* <http://www.nfib.com/Portals/0/PDF/sbet/sbet201207.pdf>.

¹⁰ U.S. BANK, SMALL BUSINESS ANNUAL SURVEY 5 (May 2012) *available at* <http://usbankconnect.com/files/2012%20U.S.%20Bank%20Small%20Business%20Annual%20Survey.pdf>.

¹¹ *Id.* at 3.

¹² *Id.*, this percentage remains unchanged from the previous year.

¹³ BUREAU OF ECONOMIC ANALYSIS, NATIONAL INCOME AND PRODUCT ACCOUNTS GROSS DOMESTIC PRODUCT, FIRST QUARTER 2012 (June 2012) *available at* <http://www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm>. During the first quarter of 2012, real GDP increased at an annual rate of 1.9 percent which is down from the fourth quarter of 2011, where real GDP increased at 3 percent.

¹⁴ Forrest Jones, *Rasmussen: U.S. Consumer Confidence Hits Five-Month Low*, MONEY NEWS, June 12, 2012, *available at* <http://www.moneynews.com/InvestingAnalysis/Rasmussen-Consumer-Confidence-us/2012/06/12/id/442063>.

through imitative growth which “occurs within the existing technological frontier,”¹⁵ or through innovative growth which “pushes that frontier outward.”¹⁶ Examples of imitative growth include “capital accumulation, expansion and upgrading of the labor force, and adaption of ideas elsewhere.”¹⁷ Whereas, innovative growth occurs with “the development of new products and new production processes.”¹⁸

For example in 2011, “durable-goods manufacturing, professional, scientific, and technical services, and information services were the leading contributors to [United States] economic growth.”¹⁹ Notably, these industries encompass both types of economic growth with technical services resulting in innovative growth, and established industries such as durable-goods manufacturing, requiring imitative growth to expand. As the array of industries above demonstrates, despite obstacles heightened by the recession, high levels of ingenuity and innovation enhance small businesses’ ability to succeed during tough economic times.

IV. Congressional Changes to Promote Small Business Success During the Recession

While small businesses sought to generate economic growth, the recession and resulting downturned economy produced a negative effect on their ability to succeed. Due to this, Congress has been active in passing legislation to stimulate the economy and also to assist small businesses, with the intent that small business growth would lower unemployment and spur economic growth.

a. American Recovery and Reinvestment Act

On February 17, 2009, President Obama signed the *American Recovery and Reinvestment Act* (ARRA).²⁰ While this legislation aimed to broadly stimulate the economy, it also recognized at least a modest need to provide direct assistance to small businesses through the Small Business Administration (SBA) Capital Access programs. Most of the changes in the ARRA focused on improving the ability of small businesses to obtain credit. Section 501 provided for reductions in fees for borrowers under the 7(a) Loan and certified development company (CDC) Programs. Section 502 authorized but did not mandate that the SBA could raise the guarantee percentage to 90 percent for all loans. ARRA provided \$375 million to fund these fee reductions and increases in the guarantee percentage.²¹ The CDC Program was bolstered in § 503 with the temporary creation of a federal guarantee on securitized first lien loans made by banks.²²

¹⁵ BRINK LINDSEY, EWING MARION KAUFFMAN FOUNDATION, FRONTIER ECONOMICS: WHY ENTREPRENEURIAL CAPITALISM IS NEEDED NOW MORE THAN EVER 5 (Apr. 2011) *available at* http://www.kauffman.org/uploadedfiles/frontier_economics_4_06.pdf.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ BUREAU OF ECONOMIC ANALYSIS, DURABLE-GOODS MANUFACTURING LED GROWTH IN 2011 (Apr. 2012) *available at* <http://www.bea.gov/newsreleases/industry/gdpindustry/gdpindnewsrelease.htm>.

²⁰ Pub. L. No. 111-5, 123 Stat. 115 (2009) (“ARRA”).

²¹ Without an appropriation, the lending programs would not have taken in sufficient funds to cover the cost of the program as required by the Federal Credit Reform Act.

²² The CDC program requires a commercial lender to provide a first lien (or mortgage) loan on the project for 50 percent of the cost. Like all loans, these first liens can be securitized but did not have a federal guarantee.

Although the primary focus of the small business provisions in the ARRA was to stimulate the credit markets, Congress recognized that small businesses were also facing difficulty in accessing equity markets.²³ Given this, the ARRA also made modest but important changes to the Small Business Investment Company (SBIC)²⁴ program in an effort to stimulate equity investment in small businesses. Section 505 increased the maximum amount of leverage available for a SBIC to obtain to \$150 million for a single SBIC or \$225 million for multiple SBICs if they are commonly controlled by the same licensee or group of licensees. Those limits could go up to \$175 million and \$250 million respectively if the SBIC or commonly controlled SBICs invested at least 50 percent of their funds in small businesses located in low-income geographic areas. Given the difficulty that smaller enterprises have in finding equity, § 505 also required licensees to devote at least 25 percent of their capital to these smaller enterprises.²⁵

b. *Small Business Jobs Act*

Although the ARRA contained provisions directed at small businesses, small firms were still suffering from the lingering effects of the Great Recession in 2010. Therefore, the Administration and Congress sought other vehicles to boost small businesses. In light of this, the *Small Business Jobs Act of 2010* was signed into law on September 27, 2010.²⁶ This Act provided tax cuts as well as increased credit, contracting, and exporting opportunities for small firms.²⁷

Specifically, Title I supplemented the changes in the SBA capital access programs by providing additional funds for reducing borrower fees and increasing the guarantee percentages through the end of 2010.²⁸ Further, Title I contained provisions related to improving small business contracting and aiding small business exporting. Title II of the Act contained tax provisions designed to aid small businesses.²⁹ Title III of the Act appropriated \$1.5 billion for the creation of the State Small Business Credit Initiative (SSBCI).³⁰ Title IV of the Act³¹ created the Small Business Lending Funding (SBLF). The concept behind SBLF is similar to the Capital

²³ Two primary problems were occurring in the equity markets. Given the overall volatility downward of the stock market during the latter half of 2008 and first half of 2009, companies would not want to go public only to see their share prices plummet as they were caught up in forces unrelated to the fundamentals of the newly public company. In addition, the ability to find equity capital was constrained by investors seeking the safety of federal government debt or having the inability to withdraw funds from illiquid investments be they commercial real estate, hedge funds, or private equity firms. For example, many wealthy investors were caught with the inability to access capital when the auction rate securities market completely collapsed. See Daisy Maxey, *Still Frozen after all These Years*, WALL ST. J., Oct. 30, 2010, available at <http://online.wsj.com/article/SB10001424052702304879604575582272276490314.html>.

²⁴ Small business investment companies (SBICs) are for-profit enterprises organized under state law as either a corporation or partnership or a variant thereof. SBICs receive a license to operate from the SBA pursuant to authority in Title III of the Small Business Investment Act of 1958, Pub. L. No. 85-699 (as amended).

²⁵ Smaller enterprises, generally start-ups, are much more reliant on credit. The provision on smaller enterprises was an effort to use SBICs and the leverage they receive from the government to invest more heavily in newer businesses.

²⁶ Pub. L. No. 111-240, 124 Stat. 2504 (“Small Business Jobs Act” or “Act”).

²⁷ *Id.*

²⁸ *Id.* at § 1704, 124 Stat. at 2553.

²⁹ *Id.* at §§ 2001- 2131, 124 Stat. at 2553-2568.

³⁰ *Id.* at §§ 3001-11, 124 Stat. at 2568-82.

³¹ *Id.* at §§ 4101-13, 124 Stat. at 2582-96.

Participation Program established under the TARP³² (*although no TARP funds*³³ were used in creating the SBLF). Title V of the Act determined the budgetary effects in order to comply with Pay-As-You-Go (PAYGO).³⁴

c. *Jumpstart Our Business Startups (JOBS) Act*

Most recently, the *JOBS Act*³⁵ was passed by Congress and signed into law by President Obama on April 5, 2012. The *JOBS Act* was designed to stimulate economic growth by promoting investment and capital formation, while decreasing the regulatory burden on small firms under the *Securities Act of 1933*, the *Securities Exchange Act of 1934*, and *Sarbanes-Oxley Act*.³⁶ The *JOBS Act* legalized a new form of investing, known as “crowdfunding,” which allows non-accredited investors to pool together to invest in a company. Furthermore, it provides exemptions for “emerging growth companies”³⁷ which allows small firms a greater chance of succeeding when going public.

Overall these Congressional changes (along with other initiatives such as the reauthorization of the successful Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR), programs)³⁸ are aimed at promoting small firms during the difficult economy. Ultimately, these policies have been intent upon ensuring private sector growth, by creating the environment necessary for small businesses to create jobs and lead the economy out of a recession as they have done historically. Despite these changes, small firms have largely had to rely on their own ingenuity and entrepreneurial spirit to navigate the tumultuous economy.

V. Small Business Approaches to Success

In order to succeed during the recession, small businesses took various approaches. As indicated previously, more established firms focused on adapting current business models to reduce costs and diversifying portfolios to ensure an array of clients. New entrepreneurs and emerging small businesses opted to capitalize on new technologies, fresh ideas, and unique perspectives. While other resilient small businesses capitalized on the recession with ingenuity and planning.

a. Re-structuring Business Models to Reduce Costs and Diversify the Client Base

³² The legislation creating the TARP was titled the Emergency Economic and Stabilization Act (EESA), Pub. L. No. 110-343, 122 Stat. 3765, *codified at* 12 U.S.C. §§ 5201-61, and signed into law by President Bush on October 3, 2008.

³³ Small Business Jobs Act, § 4111(a), 124 Stat. at 2595. To further ensure that the program does not appear to be a TARP-like bailout of smaller institutions, banks that are on the FDIC problem list are prohibited from receiving SBLF funds. *Id.* at § 4103(d)(4), 124 Stat. at 2588.

³⁴ *Id.* at § 5001, 124 Stat. at 2603.

³⁵ Pub. L. No. 112-106, 126 Stat. 206 (“Jumpstart Our Business Startups Act” or “JOBS Act”).

³⁶ Pub. L. No 107-204, 116 Stat. 745 (“Sarbanes-Oxley Act” or “SOX Act”).

³⁷ An emerging growth company is defined in the JOBS Act § 101(a).

³⁸ SBIR/STTR programs were reauthorized under the National Defense Authorization Act for FY 2012, Pub. L. No. 112-81, §§ 5001-5168.

For small businesses maintaining a happy and diverse customer base is increasingly important. As small firms struggled, 96 percent of small businesses indicated that “providing good customer service has helped them survive a tough economy.”³⁹ A decrease in sales as a result of the Great Recession forced small business owners to look at ways to reduce costs and gain clients in order to stay profitable.

A common strategy was to restructure business models to allow for expansion into new markets which offered new customers.⁴⁰ This included venturing overseas, as well as generating new uses for current products that could be marketed to different types of clients.⁴¹ By adding customers in various countries and in different industries, small firms were not burdened with being overly reliant on one client or the economy of a particular country.

Other small firms adjusted their business models by reducing bottom line costs. For example, one strategy to reduce costs at many small businesses involved reducing their marketing budgets, instead turning to lower-cost alternatives such as social media.⁴² In today’s technology-savvy society, 55 percent of entrepreneurs report using social media as a way to attract new customers.⁴³ This ability to diversify and increase clients while reducing costs has allowed a portion of small firms to prosper despite the tough economy.

b. Innovation and Emerging Companies

“Innovation is a key driver of competitiveness, job growth, and a higher standard of living for future generations.”⁴⁴ For small firms in particular, “innovation has been a constant proxy for measuring small business success.”⁴⁵ And notably, some of the most successful corporations “from Disney (DIS) to Microsoft (MSFT) were founded during economic downturns,”⁴⁶ demonstrating that during an economic recession innovation can spur substantial economic growth and job creation. In fact, “small businesses that innovate are most likely to grow into large businesses and become a source of highly technical, high-paying jobs in the future.”⁴⁷

³⁹ AMERICAN EXPRESS OPEN, BUSINESS OWNER OUTLOOK REMAINS OPTIMISTIC, BUT CAUTIOUS (Apr. 12, 2012) available at <http://www.openforum.com/articles/business-owner-outlook-remains-optimistic-but-cautious>.

⁴⁰ Anne Field, *Strategies for Growth, Even in Down Times*, N.Y. TIMES, May 9, 2012, available at http://www.nytimes.com/2012/05/10/business/smallbusiness/how-some-companies-expand-even-in-a-stalled-economy.html?pagewanted=2&_r=1&ref=smallbusiness.

⁴¹ *Id.*

⁴² AMERICAN EXPRESS OPEN, *supra* note 39.

⁴³ *Id.*

⁴⁴ U.S. DEPT. OF COMMERCE, THE COMPETITIVENESS AND INNOVATIVE CAPACITY OF THE UNITED STATES 2-1 (Jan. 2012) available at http://www.commerce.gov/sites/default/files/documents/2012/january/competes_010511_0.pdf.

⁴⁵ CJ ISOM AND DAVID R JARCZYK, OFFICE OF ADVOCACY, SMALL BUSINESS ADMINISTRATION, INNOVATION IN SMALL BUSINESSES: DRIVERS OF CHANGE AND VALUE USE 5 (Mar. 2009) available at <http://archive.sba.gov/advo/research/rs342tot.pdf>.

⁴⁶ Reena Jana, *Recession: The Mother of Innovation?*, BLOOMBERG BUSINESSWEEK, July 22, 2009, available at <http://www.businessweek.com/stories/2009-07-22/recession-the-mother-of-innovation-businessweek-business-news-stock-market-and-financial-advice>.

⁴⁷ ISOM AND JARCZYK *supra* note 45, at 7.

Fortunately, small businesses recognize the importance of innovation particularly as a means to succeed during a tough economy. For example, in order to maintain success 82 percent of business owners encourage their employees to innovate.⁴⁸ Further, entrepreneurs are often the first to recognize the value of innovation and cultivate this into an emerging industry. “Smaller firms have many advantages as sources of innovation because they are quick to adopt new and high risk initiatives; they facilitate structures that value ideas and originality; and they have a better capacity to reap substantial rewards from market share in small niche markets.”⁴⁹

In light of this trend, several small businesses in emerging industries have prospered despite the perils of emerging industry and the economy. Emerging industries are defined as “brand new industries in the early stages of growth.”⁵⁰ These are “often considered as speculative because they are introducing new products that may or may not be accepted and may face strong competition from other new entrants.”⁵¹ Given this, “these companies are likely operating on a shoestring budget, while at the same time presenting to the world a product or service that has yet to be accepted. These pioneering companies might face bankruptcy, development failure or poor consumer acceptance.”⁵² Despite the risks associated with these emerging industry companies, research opines that those successful “fast growing young-firms, comprising less than 1 percent of all companies, generate roughly 10 percent of new jobs in any given year.”⁵³ As a result of small firms’ innovation, particularly in emerging industries, they have thrived and increased private sector job growth despite the obstacles intensified by the weak economy.

c. Women-Owned Small Business

One of the best examples of adapting for success during the Great Recession can be found from women-owned small businesses (WOSBs), as “women small business owners exhibited notable resilience and adaptability throughout the economic downturn.”⁵⁴ There are approximately 7.8 million women-owned firms in the United States.⁵⁵ These firms “represent

⁴⁸ AMERICAN EXPRESS OPEN, SPRING 2012 SMALL BUSINESS MONITOR (April 12, 2012) available at <http://media.nucleus.naprojects.com/pdf/Spring%202012%20Monitor%20Release%20-%20FINAL%20%20OF%20Formatted%20version.pdf>.

⁴⁹ ISOM AND JARCZYK *supra* note 45, at 7.

⁵⁰ BMO, BMO InvestorLine- Education Center Glossary, available at <http://www.bmoinvestorline.com/EducationCentre/e.html> (last visited July 9, 2012).

⁵¹ *Id.*

⁵² Jason Van Bergen, *Great Company or Growing Industry?*, Mar. 31, 2012, available at <http://www.forbes.com/2010/03/31/stock-analysis-value-buys-personal-finance-emerging.html>.

⁵³ DANE STANGLER, EWING MARION KAUFFMAN FOUNDATION, HIGH-GROWTH FIRMS AND THE FUTURE OF THE AMERICAN ECONOMY 2 (Mar. 2010) available at <http://www.kauffman.org/uploadedfiles/high-growth-firms-study.pdf>.

⁵⁴ WILLIAM DENNIS, NATIONAL FEDERATION OF INDEPENDENT BUSINESS, SMALL BUSINESS: LESSONS OF THE RECESSION WOMEN-OWNED BUSINESSES ADAPT AND EMERGE STRONGER 1 (2012) available at <http://www.nfib.com/Portals/0/PDF/AllUsers/research/studies/nfib-chase-wob-study-2012.pdf>.

⁵⁵ U.S. DEPT. OF COMMERCE AND ECONOMICS AND STATISTICS ADMINISTRATION, FOR THE WHITE HOUSE COUNCIL ON WOMEN AND GIRLS, WOMEN-OWNED BUSINESSES IN THE 21ST CENTURY 1 (Oct. 2010) available at <http://www.esa.doc.gov/sites/default/files/reports/documents/women-owned-businesses.pdf>.

one of the fastest-growing segments of the economy,⁵⁶ experiencing growth at 43.8 percent which is nearly twice as fast as men-owned firms.⁵⁷ It has been estimated that by 2018, women-owned firms will be responsible for creating approximately 5.5 million new jobs in the United States.⁵⁸

While 49 percent of WOSBs still face lower sales today than when the recession began, these firms provide further examples of the best practices employed by small firms to cope with the effects of the economic recession.⁵⁹ In order to combat the recession, WOSBs primarily focused on changing existing business models by controlling costs, altering operating hours, and invigorating sales through new markets and increased promotion through avenues such as social media.⁶⁰

VI. Conclusion

Notably, small firms have experienced the brunt of this tough economy; as the United States continues to combat weak economic growth and rampant levels of high unemployment. While these economic obstacles have generally restricted small business owners, there have been triumphs due to the entrepreneurial spirit, ingenuity, and resilient nature of small business owners across America.

⁵⁶ Office of Women's Business Ownership, Small Business Administration, Women Entrepreneurs Summit Series Report 1 (2012) *available at*

<http://www.sba.gov/sites/default/files/Womens%20Entrepreneurs%20Summit%20Series%20FINAL.pdf>.

⁵⁷ NATIONAL WOMEN'S BUSINESS COUNCIL, WOMEN-OWNED FIRMS IN THE U.S. 23 (Jan. 2012) *available at*

<http://www.nwbc.gov/sites/default/files/NWBC%20Final%20Narrative%20Report.pdf>.

⁵⁸ The Guardian Life Small Business Research Institute, Women Small business Owners Will Create 5+ Million New Jobs by 2018, Transforming the Workplace for Millions of Americans 3 (Dec. 2009) *available at*

http://www.smallbizdom.com/glif11pp/groups/camp_internet/@stellent_camp_website_smallbizdom/documents/report/women-small-business-owners.pdf.

⁵⁹ DENNIS, *supra note 54*, at 1-2.

⁶⁰ *Id.* at 1-7.