

# New Business Formation, Small Businesses, and Policies

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*Small Business, Entrepreneurship, and Economic Recovery Conference:*

*A Focus on Job Creation and Economic Stabilization*

October 26, 2010



# Summary

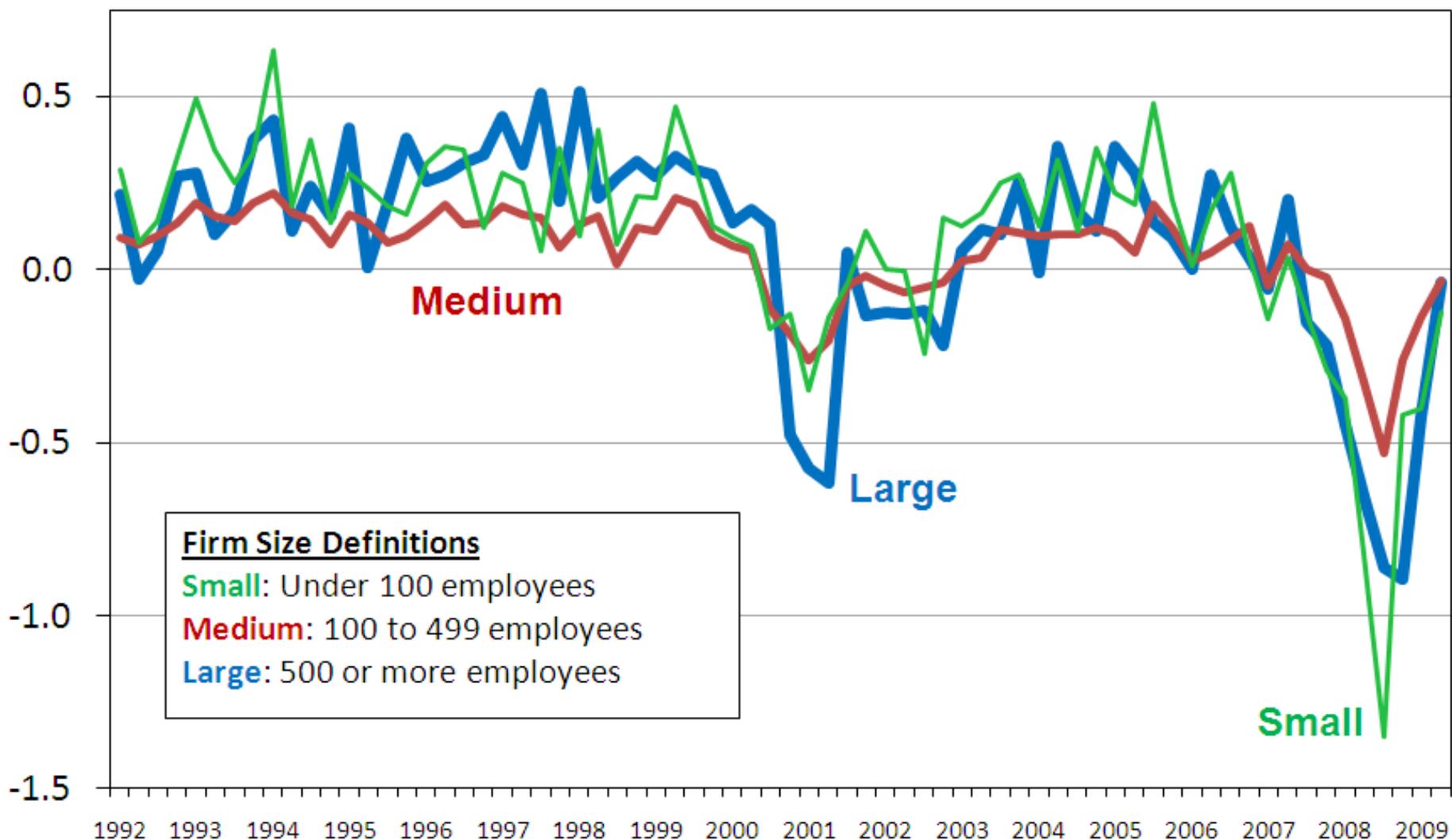
1. What we know about the economic downturn and new business formation and small business performance
2. Why this is such an important topic
3. Policies
4. Some remaining questions

# What we know about the economic downturn and new business formation and small business performance

- Not as much as we would like
  - Severe data constraints
  - Especially on the financing side
- Anecdotes
- For small businesses, business employment dynamics

# Quarterly Net Job Changes by Firm Size

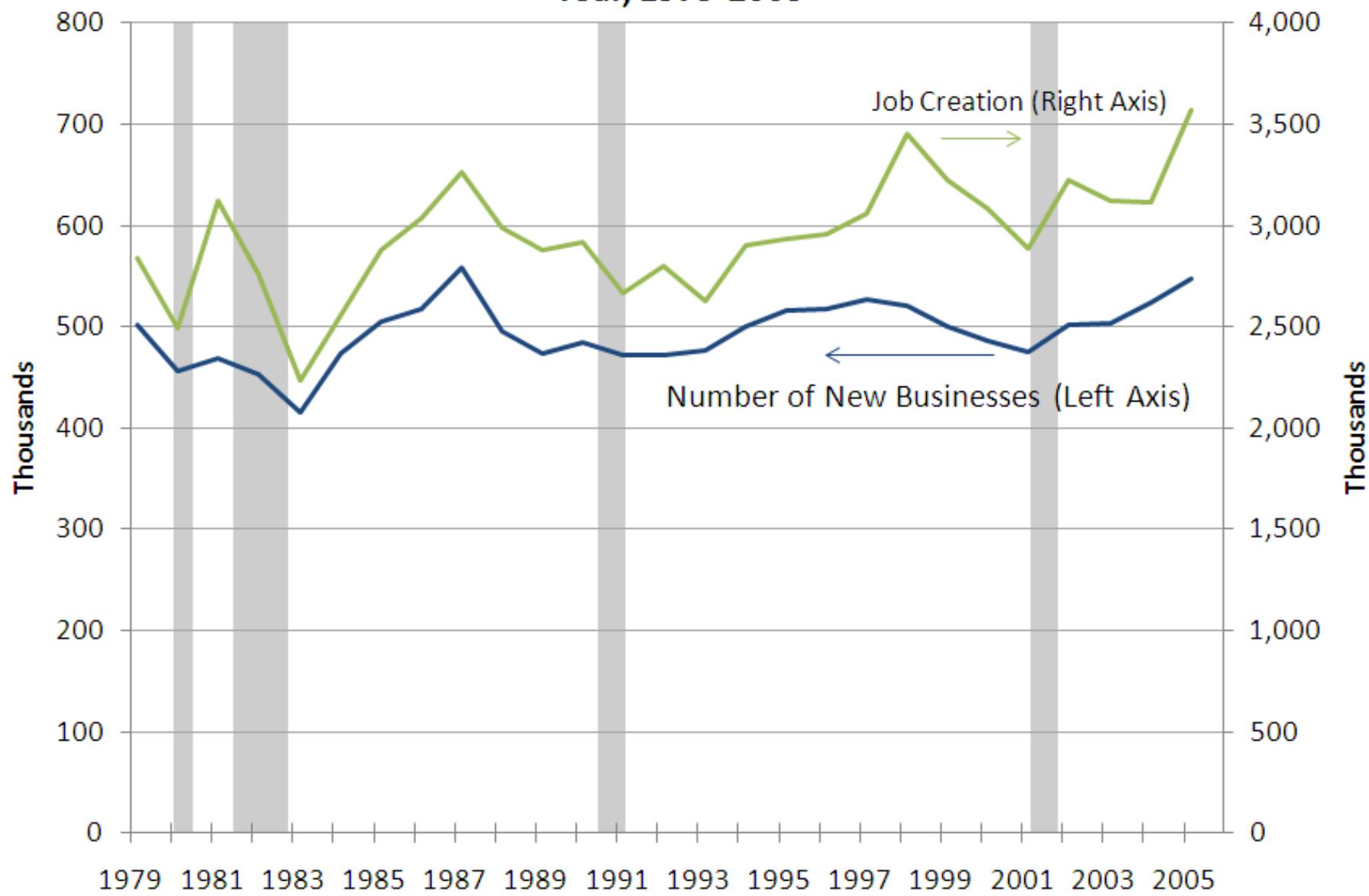
1992Q3-2009Q4, millions



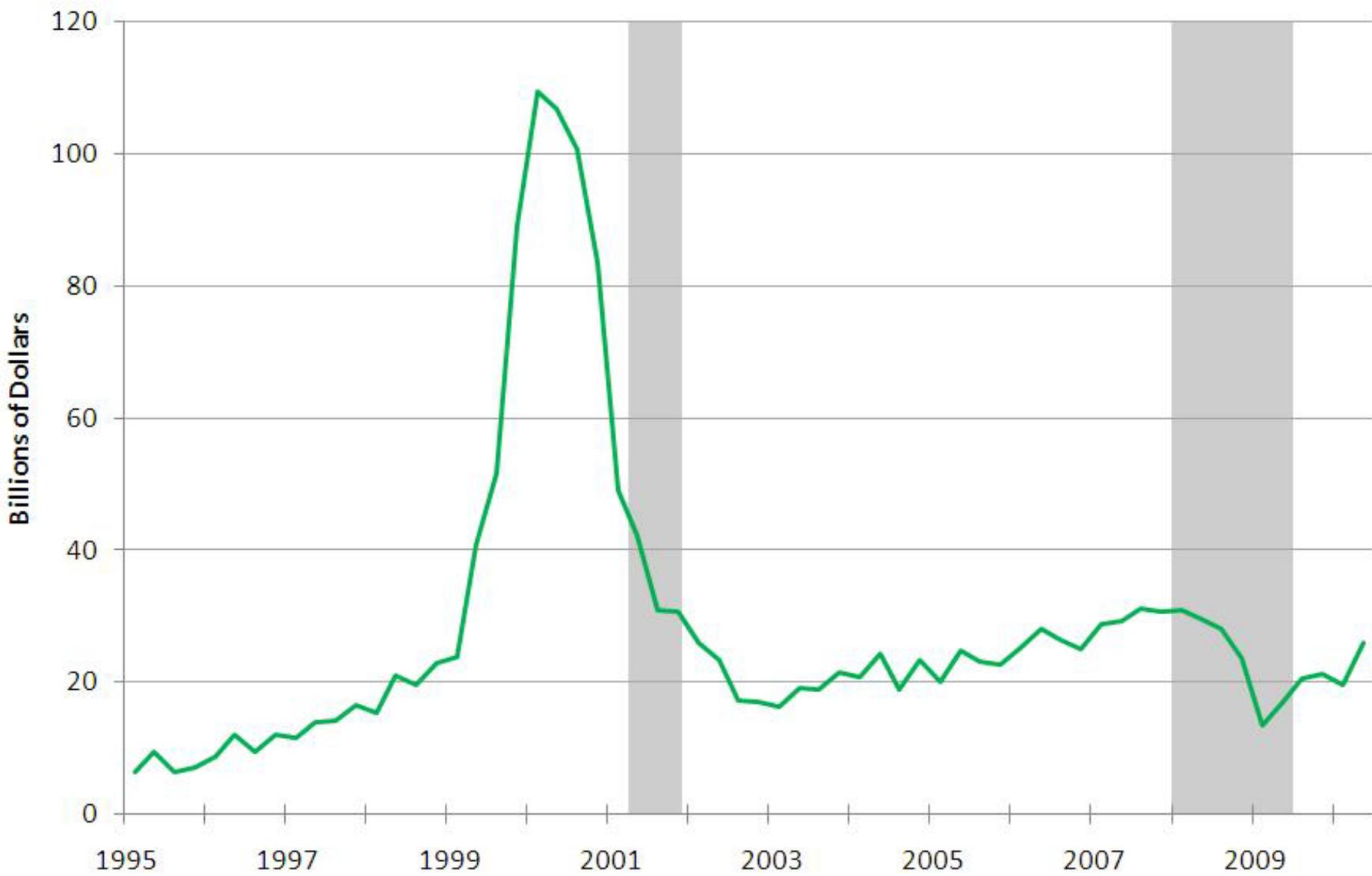
# What we know about the economic downturn and new business formation and small business performance

- Not as much as we would like
- Anecdotes
- For small businesses, business employment dynamics
- **New firm formation**

## New Employer Firm Formation: Number of Firms and Job Creation by Year, 1979-2005



# Venture Capital Spending



Source: PriceWaterHouseCoopers/National Venture Capital Association MoneyTree  
Quarterly data at an annual rate

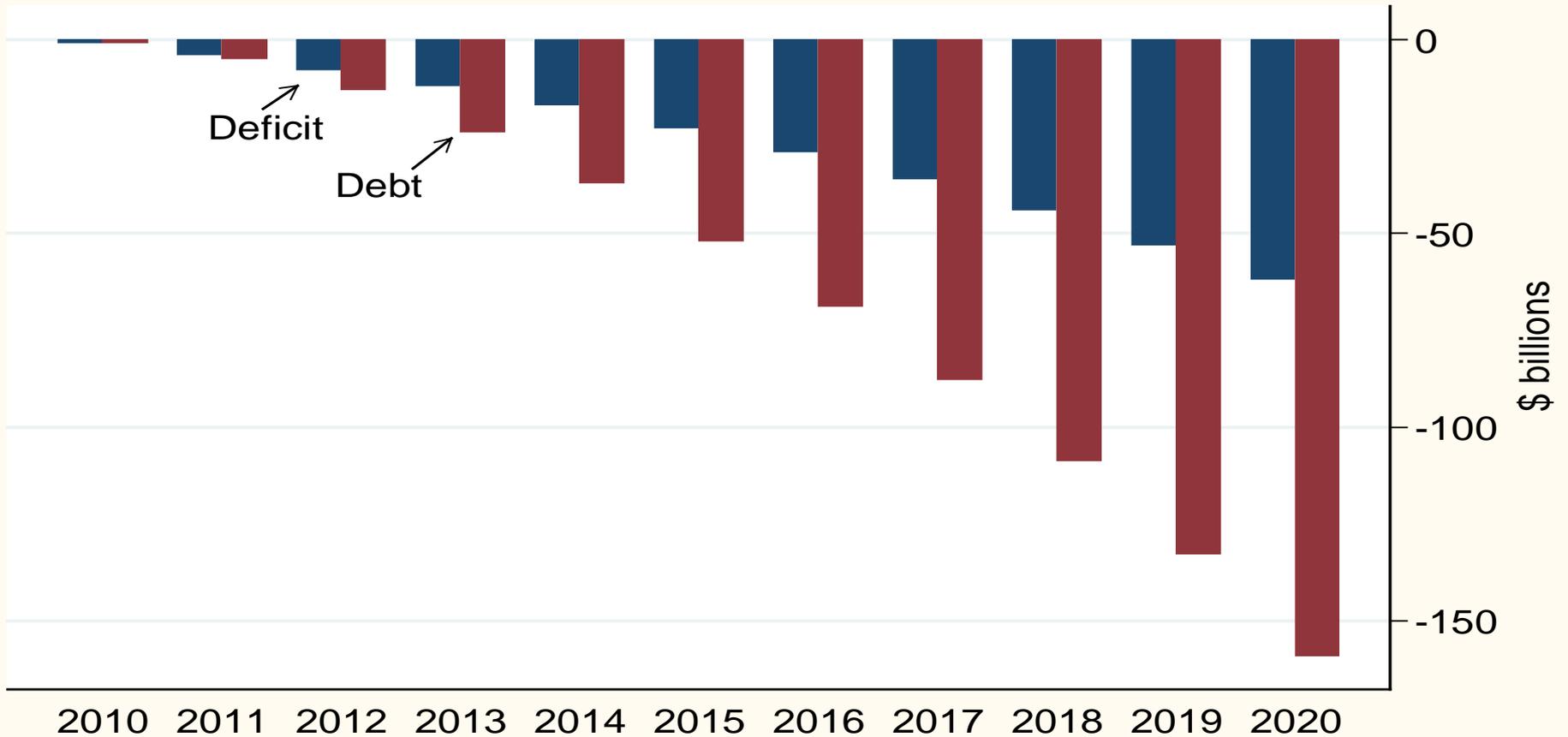
■ Recession    — Venture Capital

# Why this is such an important topic?

- Employment
- Innovation/economic growth
  - Reallocation
  - New products and services
  - Competition

# Potential Budget Implications

Changes in Federal Deficits and Debt from a 0.1 Percentage Point Increase in Annual Growth: 2010 to 2020



Source: CBO

# Policies

- Demand
- Finance / credit
- Taxes
- Other Federal
- State-level

# Policies: demand

- Demand: policies that enhance aggregate demand, boosting the demand for products and services of small/new businesses, and to reduce uncertainty
  - ARRA
    - General demand
    - Specific sectors: Reed
  - Financial regulatory reform
  - Other programs to boost demand, such as UI

# Policies: finance

## Questions

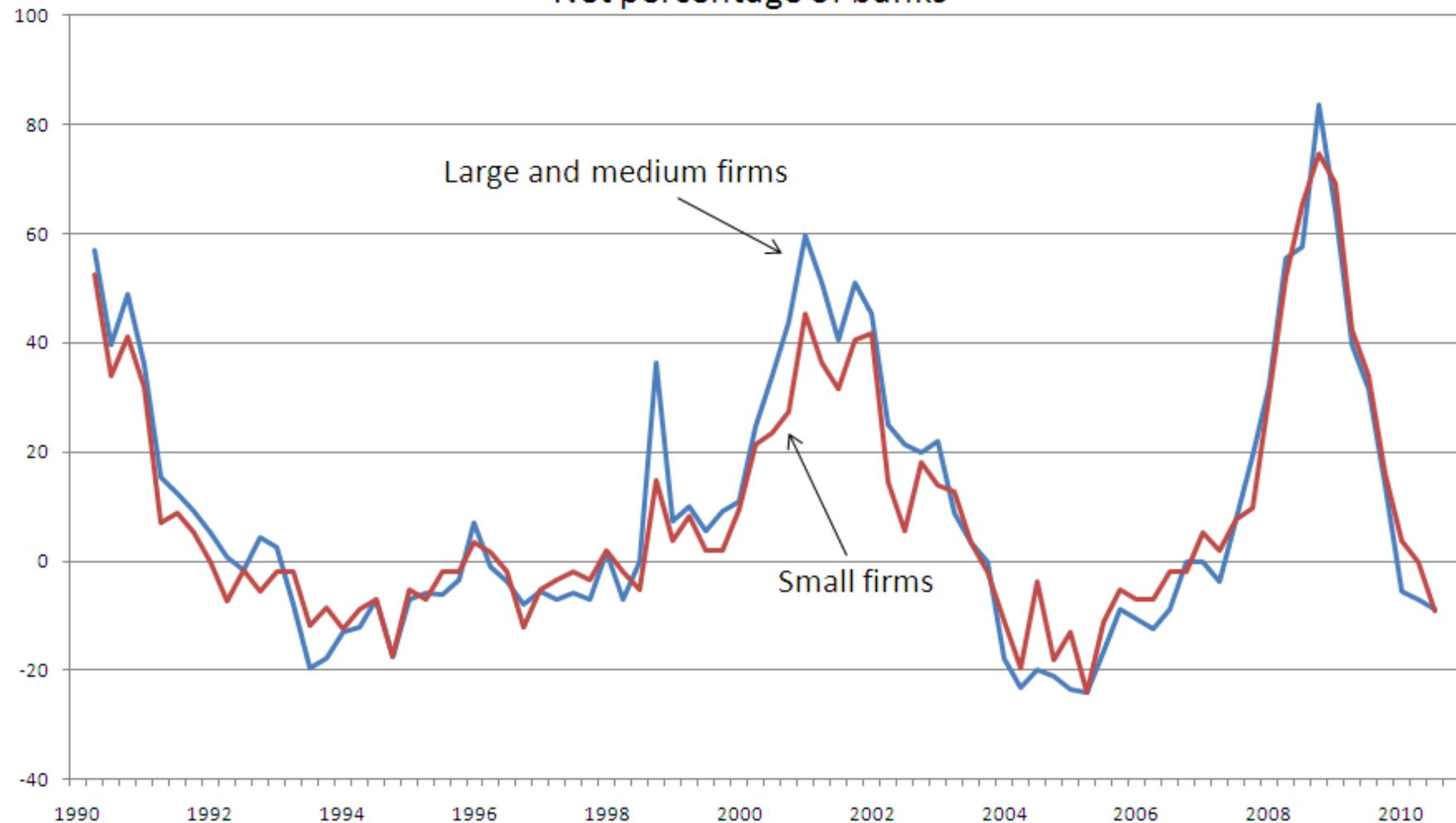
- Supply or demand?
- For supply: to what extent did lending standards to small/new businesses change as a result of the financial crisis?
- Was the change more than a standard cyclical effect?
- How do standards now compare to pre-housing bubble?

# Policies: finance, supply

## Tightening Standards for C&I Loans

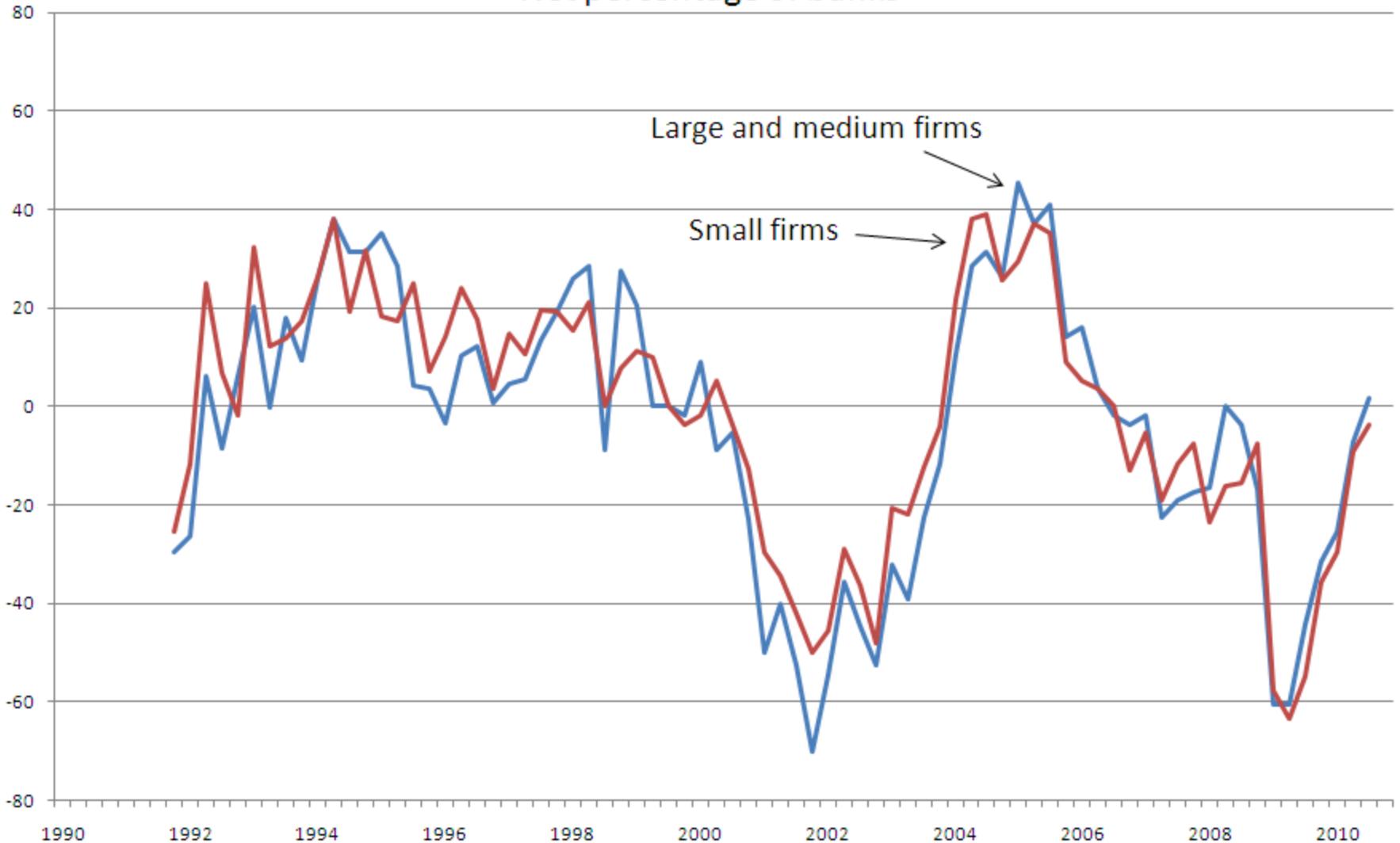
By size of firm seeking loan

Net percentage of banks



# Policies: finance, demand

**Stronger Demand for C&I Loans**  
By size of firm seeking loan  
Net percentage of banks



# Policies: taxes

Cut taxes for small businesses 16 times, bringing about \$55 billion in tax relief over the next year

- Bonus Depreciation Tax Incentives to Support New Investment
- 75% Exclusion of Small Business Capital Gains
- New Small Business Health Care Tax Credit
- A New Tax Credit for Hiring Unemployed Workers
- Expansion of Limits on Small Business Expensing
- Five-Year Carryback of Net Operating Losses
- ...

# Policies: finance

- Restore stability to financial markets
- Small Business Lending Fund – \$30 billion
  - Provide smaller community banks with low-cost capital (as low as 1%) if they go above and beyond 2009 small business lending levels.
  - Potentially supporting several multiples of that amount in new credit.
- More than double the amount that small business owners can borrow through the SBA's programs
- Strengthen state programs that spur private sector lending to small businesses

# Policies: innovation

- Intellectual property: Patent reform, IP enforcement
- ARRA R&D spending: large increases in federal R&D spending, especially non-defense: Increase government/university commercialization
- Small Business Innovation Research (SBIR) and Small Business Technology Transfer (STTR) program at agencies with sizeable R&D budgets.
- Commerce Department's Innovation in Economic Development Awards (particularly the Award category for Innovation in Commercialization) (Commerce/EDA)

# Policies: other federal

- Healthcare reform
  - Health insurance insecurity locks people into jobs and keeps people from becoming entrepreneurs
  - Helps small businesses/entrepreneurs attract talented workers.
- National export initiative
- Greater attention to new businesses:  
Commerce Department of Commerce's  
Office of Innovation and Entrepreneurship
- Housing

# Policies: state-level

- Grants (ex: OH, MA, NY, MD, ME, SC)
- Loans (MI, SC)
- Equity Capital (MI, PA, CT)
- Tax Credits (IN, SC, CT, NY, PA, MA)
- Venture Capital (IN, OH, IA, AR, OK)
- Private Equity (CT)

# Some remaining questions

- What avenues best promote new business formation in the current environment?
- What policies could gain wide-ranging support?
- What policies are most affordable? Have the highest rate of return?

# Some remaining questions

- Many of the positions created by new businesses will be lost and many of these firms will close
- How much new firm formation should there be?
  - Resource costs associated with this turnover
  - Quantity/quality: If policies affect the “marginal firm”, then are we going to get more Google’s or disproportionately more failures?