

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-0315

Memorandum

To: Members, Committee on Small Business
From: Committee Staff
Date: June 20, 2018
Re: Hearing: “Communities That Think Small and Win Big”

On Wednesday, June 20, 2018 at 11:00 A.M., the Committee on Small Business will meet in Room 2360 of the Rayburn House Office Building for a hearing titled “Communities That Think Small and Win Big.” The purpose of the hearing is to highlight localities that have developed thriving small business ecosystems. The hearing will examine key elements of a business-friendly environment as well as the socioeconomic returns on small business investment. Members will have the opportunity to discuss economic development policy strategies and determine best practices.

I. Introduction

On Thursday, April 12, 2018, the Subcommittee on Investigations, Oversight, and Regulations held a hearing titled, “Community Support: Entrepreneurial Development and Beyond.” The hearing examined the complex and reciprocal relationship between small businesses and their communities. Participants discussed the role of local communities and resource organizations that offer business support and networking opportunities.

There are a myriad of rankings and indices designed to evaluate the business climate at the local, state, and national levels. Although limited in scientific validity, they draw attention to policies and resources that create a favorable business environment. At this hearing, the Committee will further its understanding of the small business-community relationship, with a specific focus on how economic development practitioners (both policymakers and supporting organizations) prioritize small business support to achieve local and regional revitalization goals.

II. Return on Small Business Investment

With 30.2 million small businesses in the United States employing 47.5 percent of Americans, small business success is essential to the economic well-being of individual communities throughout the country, as well as our nation overall.¹ In return for community support, small businesses are known to have a positive effect on the local economy and culture.

¹ U.S. SMALL BUS. ADMIN., SMALL BUSINESS PROFILE, UNITED STATES (2018), available at <https://www.sba.gov/sites/default/files/advocacy/2018-Small-Business-Profiles-US.pdf>.

A. Multiplier Effect

Small businesses are important players in their local economies due to the multiplier effect. Statistically, less than 14 percent of the money spent at chain businesses is later recirculated locally, compared to 48 percent of purchases spent at local independent businesses.² In a community retail study, small businesses generated “3.7 times more direct local economic benefit than spending at chains.”³ While all small businesses produce the multiplier effect, the magnitude of impact depends on the type of business. Small businesses with the highest local premium include restaurants and service providers, followed by retailers.⁴

The multiplier effect of small businesses can benefit local communities through direct impact, indirect impact, and induced impact.⁵ Direct impact refers to the spending small business do in their local economy, such as paying local utilities, employees, or suppliers. Indirect impact is the process of the dollar that a business spent directly being recirculated in the community (i.e., when the local utility pays its employees). Induced impact happens when the owners, employees, or customers of the small business spend their income in the local economy due to their physical presence within the community.⁶

B. Cultural Effect

Local revitalization campaigns rely on small businesses to spark economic growth and foster a vibrant community. New and redeveloping neighborhoods haven taken on an entrepreneurial spirit that encourages the innovative, agile, and unique, instead of a large scale, one-size-fits-all, approach.⁷ Community leaders promote small business success to attract financial investors, skilled workers, and tourists to their district and surrounding areas.⁸ An example of this strategy is the growing number of “beer trails” initiated by craft brewer guilds. Local governments and tourism boards have capitalized on beer tourism by publishing trail maps, offering contests and prizes, hosting events, and running social media promotions.

From craft breweries to independent book shops, many consumers opt to shop locally to personally connect with producers, whether farmers, bakers, or artisans.⁹ Support for local small businesses strengthens social connections, generates pride, and ultimately creates a more resilient community.¹⁰

III. Policy Strategies to Support Small Businesses

Taxes and public services affect economic development; however, the impact is difficult to quantify and analyze.¹¹ Localities can use a variety of policy tools to address primary business

² TEN STUDIES OF THE “LOCAL ECONOMIC PREMIUM,” AM. INDEP. BUS. ALLIANCE (Oct. 2012), *available at* <https://www.amiba.net/resources/studies-recommended-reading/local-premium/>.

³ *Id.*

⁴ *Id.* at 2.

⁵ *Id.*

⁶ *Id.*

⁷ NATIONAL MAIN STREET CENTER, MAIN STREET AMERICA, STATE OF MAIN 51 (Feb. 2018) [hereinafter “STATE OF MAIN”], *available at* <https://www.mainstreet.org/viewdocument/state-of-main-2018-hi-res>.

⁸ *Id.* at 42.

⁹ *Id.* at 52.

¹⁰ *Id.* at 53.

¹¹ Katharine Bradbury, Yolanda K. Kodrzycki & Robert Tannenwald, *The Effects of State and Local Public Policies on Economic Development: An Overview*, NEW ENGLAND ECONOMIC REVIEW 5 (March 1997) [hereinafter

concerns including operating costs, operating conditions, and quality of life.¹² When considering policy changes to spur economic development, policymakers must consider both indirect and direct effects on residents, businesses, and the overall community.¹³ Additionally, localities should tailor their strategy to meet the needs of the types of businesses they want to attract.

C. Regulation

Small businesses struggle to operate within a complex web of local, state, and federal regulations. The 2017 National Small Business Association (NSBA) Regulations Survey found that startups spend an average of \$83,019.23 in regulatory costs in their first year.¹⁴ After that, the average small business owner spends at least \$12,000 regulatory costs per year.¹⁵ City commissions have found that complex and often conflicting regulation discourages business from the area.¹⁶ In response, local governments have consolidated outdated regulations, simplified procedures, streamlined overlaps, and improved public access to regulation information and assistance.¹⁷

D. Taxes

According to the NSBA Regulations Survey, local, state, and federal taxes are a burdensome regulation for small business owners.¹⁸ Local governments offer a variety of incentives and subsidies to attract firms to economically distressed areas which may include cost reimbursements, financing, tax relief.¹⁹ Tax benefits may include corporate income tax credits, sales tax exemptions, property tax abatement, and tax increment financing.²⁰ Incentives may be awarded individually or as part of a package; enterprise zones typically combine tax relief, financing, and reduced regulation.²¹ These awards are a popular economic development strategy; however, their impact is difficult to determine and small businesses have largely been excluded.

E. Access to Capital

The number of community banks and credit unions in the United States has declined significantly in recent years, which has had a significant impact on small business access to capital. Between 1984 and 2011, the number of financial institutions with less than \$25 million in assets declined by 96 percent.²² Although community banks hold only 13 percent of total industry assets, they make up more than 50 percent of all small business loans.²³ This is in large

“Effects”], available at <https://www.bostonfed.org/publications/new-england-economic-review/1997-issues/issue-march-april-1997/the-effects-of-state-and-local-public-policies-on-economic-development-an-overview.aspx#4ae4bab9-e3af-44a5-bd65-e5c55bdf6bfb>.

¹² *Id.* at 6.

¹³ *Id.* at 5.

¹⁴ NAT’L SMALL BUS. ASS’N, 2017 NSBA SMALL BUSINESS REGULATIONS SURVEY 6 (2017) [hereinafter NSBA] available at <http://www.nsba.biz/wp-content/uploads/2017/01/Regulatory-Survey-2017.pdf>.

¹⁵ *Id.* at 9.

¹⁶ NANCEY GREEN LEIGH & EDWARD J. BLAKELY, PLANNING LOCAL ECONOMIC DEVELOPMENT: THEORY AND PRACTICE 137 (6th ed., 2017) [hereinafter “LEIGH & BLAKELY”].

¹⁷ *Id.* at 137.

¹⁸ NSBA *supra* note 14 at 4.

¹⁹ LEIGH & BLAKELY, *supra* note 16, at 302.

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ FEDERAL DEPOSIT INSURANCE CORPORATION, FDIC COMMUNITY BANKING STUDY 1 (2012), available at <https://www.fdic.gov/regulations/resources/cbi/report/cbsi-execsumm.pdf>.

part due to the fact that community bank lending to small businesses heavily relies on relationship-based lending.²⁴ With this precipitous decline in small financial institutions, many small businesses have had to resort to other financing methods to operate and expand their businesses. Communities can facilitate greater access to capital by funding research; development; and commercialization efforts at local universities; offering tax incentives for private investment; and supporting community development corporations (CDCs).²⁵

F. Access to Resources

At the community level, policymakers can make the biggest impact on small businesses by facilitating connections between business owners and service providers. Many local governments offer one-stop business centers that serve as the key contact point between business and government.²⁶ A well informed and respected liaison can reduce headaches and foster mutual trust.²⁷ Local officials also collaborate with organizations such as Chambers of Commerce, industry groups, tourism boards, and Small Business Administration resource partners.

A popular strategy of local public-private partnerships is the creation of clusters which are geographic concentrations of industry specific “firms, suppliers, support services, specialized infrastructure, producers of related products, and specialized institutions (e.g., training programs and business associations).”²⁸ To develop a cluster, community leaders choose an industry that matches the locality’s already existing asset base which may include natural resources, skilled workforce, ports, research universities, and suppliers/consumers.²⁹ Small businesses that are located within a or near a cluster enjoy more efficient transactions, technology and information sharing, flexible operations, and increased access to markets.³⁰

IV. Rankings

Considering the vast array conditions that impact small businesses, many academic and media ranking systems can be used to measure and compare business climates. Ranking systems are a popular tool of local marketing campaigns; however, experts warn that the studies cannot perfectly measure complex, multi-faceted phenomenon that shape business climates.³¹ No two business climate indexes are alike; each is unique in its methodology, scientific validity, and

²⁴ Federal Reserve Governor Lael Brainard, Address at the Third Annual Community Banking and Policy Conference (September 30, 2015), *available at* <https://www.federalreserve.gov/newsevents/speech/brainard20150930a.htm>.

²⁵ Effects, *supra* note 11 at 9.

²⁶ LEIGH & BLAKELY, *supra* note 16, at 290.

²⁷ *Id.*

²⁸ MICHAEL E. PORTER, CLUSTERS AND ECONOMIC POLICY: ALIGNING PUBLIC POLICY WITH THE NEW ECONOMICS OF COMPETITION, HARVARD BUSINESS SCHOOL, INSTITUTE FOR STRATEGY AND COMPETITIVENESS 1 (Nov. 2007) [hereinafter “Porter”], *available at* https://www.hbs.edu/faculty/Publication%20Files/Clusters_and_Economic_Policy_White_Paper_8e844243-aa23-449d-a7c1-5ef76c74236f.pdf.

²⁹ LEIGH & BLAKELY, *supra* note 16, at 287.

³⁰ PORTER *supra* note 28, at 2.

³¹ YASUYUKI MOTOYAMA, PH.D. & JARED KONCZAL, HOW CAN I CREATE MY FAVORITE STATE RANKING: THE HIDDEN PITFALLS OF STATISTICAL INDEXES, COUNCIL FOR COMMUNITY AND ECONOMIC RESEARCH (Sept. 2013) [hereinafter “RANKING”], *available at* <http://journal.c2er.org/2013/09/how-can-i-create-my-favorite-state-ranking/>.

public credibility.³² For the purpose of this hearing, three ranking systems were used find small business friendly communities and depict the complexities of these environments.

The Kauffman Index of Main Street Entrepreneurship measures established small business (more than five years old with less than 50 employees) at the national, state, and metropolitan level.³³ The study only measures the top 40 largest metro areas, but offers a comprehensive study of small business activity by measuring:

1. **The Rate of Business Owners** in the economy, calculated as the percentage of adults owning businesses as their main jobs.
2. **The Survival Rate** of firms, calculated as the percentage of firms that remain in operation throughout their first five years. For instance, the 2015 cohort consists of the percentage of firms that started five years ago (in 2010) and are still in business in 2015.
3. **The Established Small Business Density**, measured as the number of established small employer businesses normalized by the total number of firms.³⁴

The Thumbtack Small Business Friendliness Survey asks small business owner-operators who use Thumbtack.com³⁵ about their perceptions of the business and policy environment at the local and state level.³⁶ Instead of a ranking system, Thumbtack grades each area and presents a scorecard. The survey is limited to Thumbtack.com users (13,284 responses) but the scope of the survey measures states and metro areas across 12 dimensions including:

1. Overall business friendliness
2. Ease of starting a small business
3. Ease of hiring a new employee
4. Overall regulatory friendliness
5. Friendliness of health and safety regulations
6. Friendliness of employment, labor, and hiring regulations
7. Friendliness of tax code and tax regulations
8. Friendliness of licensing requirements
9. Friendliness of environmental rules
10. Friendliness of zoning regulations
11. Availability of helpful training or networking programs
12. Availability of easy-to-use government websites³⁷

³² *Id.*

³³ EWING MARION KAUFFMAN FOUNDATION, KAUFFMAN INDEX ENTREPRENEURSHIP SERIES (2017), available at <https://www.kauffman.org/kauffman-index>.

³⁴ *Id.*

³⁵ For more information about Thumbtack.com, see <https://www.thumbtack.com/pro-center/get-hired-guide/how-thumbtack-works/>.

³⁶ LUCAS PUENTE, 2017 THUMBSTACK SMALL BUSINESS FRIENDLINESS SURVEY: METHODOLOGY & ANALYSIS, THUMBSTACK.COM 1 (Oct. 2017), available at <https://www.thumbtack.com/survey#/2017/1/states>.

³⁷ *Id.* at 4-5.

The WalletHub Best Cities to Start a Business Ranking focuses on startups, which complements the Kauffman Main Street focus on established businesses. The study compares 182 cities across three dimensions which were evaluated using 19 weighted metrics.³⁸

1. **Business Environment:** Length of Average Work Week (in Hours), Average Growth in Number of Small Businesses, Startups per Capita, Average Growth of Business Revenues, Five-Year Business-Survival Rate, Industry Variety, Entrepreneurship Index, Job Growth.
2. **Access to Resources:** Financing Accessibility, Venture Investment, Prevalence of Investors, Human-Capital Availability, Higher-Education Assets, Share of College-Educated Population, Working-Age Population Growth.
3. **Business Costs:** Office-Space Affordability, Labor Costs, Corporate Taxes, Cost of Living.³⁹

V. Conclusion

Localities across the United States are constantly evolving their policies and resource offerings to create an environment that is conducive to small business growth. At this hearing, Committee Members will have the opportunity to hear from representatives of communities that have capitalized on small business success to achieve larger economic and social revitalization goals.

³⁸ ADAM MCCANN, 2018'S BEST & WORST SMALL CITIES TO START A BUSINESS (Apr. 2016), available at <https://wallethub.com/edu/best-small-cities-to-start-a-business/20180>.

³⁹ *Id.*