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## **The Future of Small Business Overview of the Brookings - Small Business Administration's Working Group Session March 15, 2010**

We at the Brookings Institution had the honor of co-sponsoring a forum with Karen Mills, the Administrator of the Small Business Administration, and her team, on March 15<sup>th</sup>. The forum focused on establishing a framework for the design of public policy decisions to support job creation through small businesses with high growth potential. It was intended as the first step towards finding more effective answers by gathering a select group of academic theorists, think tankers, government policymakers, financiers, and entrepreneurs to discuss the overall issues that will need to be tackled in more detail as we move forward. This paper summarizes the key points that were discussed and adds some of our own reflections. While the content in this document reflects the views of the participants of the forum, none of the opinions presented or policy solutions proposed in the document have been endorsed by the SBA, the Obama Administration, or Brookings, except where explicitly stated.

The forum was conducted on the basis that comments would not be attributed afterwards to specific individuals, in order to encourage a completely free discussion. In a few cases, it has seemed important to make clear in this paper who was speaking. For example, Karen Mills' opening remarks lay out the specific purposes of the forum and we felt it would make a difference for the reader to be aware that these objectives were set by the SBA. In all cases, we received specific permission from the speakers to attribute their remarks.

The paper is organized around the following questions:

- What do we know about high-growth small businesses?
- What barriers exist that block high-growth small businesses?
- What should be America's policy goals for small business, particularly with regard to employment?
- What are our initial policy suggestions?

### **The background and tasks for the forum**

Martin Baily, of Brookings, opened the gathering by emphasizing the twin reasons for holding a forum on encouraging job growth at small businesses. First, unemployment is the worst problem the economy currently faces and is a contributor to many other economic problems, so

there is excellent reason for the Administration's choice to tackle unemployment as its number one priority. Second, small business has been a main driver of net employment growth for many years now, suggesting that improvements in public policy towards small business have the potential to yield a considerable number of additional jobs. At the same time, large companies are also important for total employment, so actions should not be taken that do offsetting damage to large firm employment. To get the economy back to full employment, both small and large businesses must grow.

Karen Mills laid out the tasks for the day's gathering, which she described as the first of a series that will examine how innovation, entrepreneurship, and small business come together to create job growth. The invitees to the initial gathering were disproportionately academics because she felt it was important to start by building a sound analytical framework that takes advantage of the best research that already exists. This research describes a dichotomy in the SBA's world that is also very clear to those most directly involved. The SBA serves both "Main Street" businesses that are often not growth-oriented and another set of businesses that strive for more rapid growth and are generally somewhat larger.

The Main Street businesses consist of restaurants, car repair shops, dry cleaners, and the myriad of other small operations that we use in our daily lives. They are a critical part of the economy, and of the SBA's mission, even though they do not tend to contribute very strongly to net job growth. In fact, their lives are often relatively short, as we can envision by remembering that corner where one restaurant after another opens, and then closes, over the decades. The SBA has a crucial role in helping Main Street firms find funding to start up and then providing them the guidance and ongoing funding assistance to increase their chance of survival and, in some cases, growth. The SBA recognizes the high level of churning of these businesses, a symptom of the fact that many close, but we also know that in normal times new businesses open in large numbers to replace the old ones. If the process of new business formation fails, there will be a significant net destruction of jobs and harm to communities.

While the Main Street restaurants and repair shops are important to the economy and to the SBA, this forum focused primarily on the second category of small businesses, those with an ambition for rapid growth. Sixty four percent of net new jobs over the last 15 years came from small business and a substantial portion of those new jobs were created by "gazelles". These are high growth, high impact small businesses. The extreme examples that stick in people's minds tend to be in high-tech industries. Google and E-bay and other success stories were gazelles for a significant part of their lives before they graduated to be truly large businesses. However, gazelles exist in all industry types and in all geographies across the country. For example, Potbelly Sandwiches, a restaurant chain in the Washington, DC area, is a non-tech example, as is the Gymboree Corp., the provider of child development programs and children's clothing.

Karen Mills pointed out that the SBA has a powerful set of policy tools including:

- An \$80 billion loan guarantee portfolio
- Specialized counseling and training centers, such as Small Business Development Centers, Women's Business Centers, and chapters of SCORE
- Specialized business development programs targeting the socially and economically disadvantaged

- Official responsibility to ensure that at least 23% of federal government contracts go to small businesses
- Several enterprises, including the Small Business Innovation Research (SBIR) and Small Business Investment Companies (SBIC) programs, to target innovation-based businesses

She also emphasized that the SBA staff were not at the forum solely to represent their own agency, but also to help gather ideas for the whole Administration. In fact, a number of other government policymakers were in attendance in order to participate directly. This Administration, she emphasized, is focused on ensuring that all relevant government agencies work together to tackle common problems. For example, the Departments of Energy, Commerce, Housing and Urban Development, Education and Labor, along with the National Science Foundation and SBA, have recently worked together to support an Energy Regional Innovation Cluster. Therefore, the gathering was urged not to confine discussion only to ideas that the SBA could implement on its own.

Karen Mills asked the gathering to focus on how to take all of these tools, across the government, and use them to encourage high growth, high impact companies. She stated that we do not yet have a good foundation for federal policy that says who these businesses are, why they are important, and how we can best help them.

### **What do we know about high-growth small businesses?**

Much of the first part of the session consisted of a review of what we know about growth of employment at small businesses. The first presenter divided the small business world into two categories: “mice,” which correspond fairly closely to Karen Mills’ “Main Street” category; and “gazelles” which are companies that grow substantially and create a large share of job creation and increased productivity. Mice are an important part of the eco-system of the economy, and should not be disregarded, but the gazelles drive net job growth and may have different policy needs. The presenter noted four key points about gazelles that came out of his data:

- A continuous flow of new companies is important, since others mature and slow their growth and eventually start to lose jobs
- The entrepreneurs who start these companies are critical to their success and growth
- Regions do matter. Some regions do better than others, although the difference may not be huge in absolute numbers
- Age of the firm is one of the most significant factors in looking for firms with high growth -- gazelles tend to grow most dramatically over a period of a few years that can start anytime, but generally occurs after at least four years of existence and before they become truly mature

One data issue on the growth patterns of gazelles came up in a side discussion at the forum. It is not clear how to handle growth by acquisition. The data often does not distinguish between a 100-employee firm adding 50 employees through organic growth or adding 50 through an acquisition. The first represents an important increase in net employment while the latter has only indirect effects on employment by improving or harming the economic viability of the entities involved. This data issue may help explain some disagreement on the timing of highest growth for gazelles.

The other two presenters in the first session confirmed the broad contours of this story and also underlined one very important fact. Gazelles do not predictably occur in any one industry or region. They are spread all over the country and do almost anything. In particular, it is critical to understand that the large majority is not in high-tech industries, despite stereotypes. In fact, the three largest industry categories for high growth companies are: restaurants; administrative services; and healthcare companies. One reason why gazelles are spread across industries is clarified by data shown by one of the presenters demonstrating how the economic performance of different firms varies widely within an industry. That is, there is a great deal of difference in the quality of the best firms and worst firms within industries. In consequence, the best firms pick up market share and employment from the worst firms, in addition to being affected by the trend growth rate within an industry.

One participant raised a question that was primarily answered implicitly over the course of the day: what characteristics are associated with future gazelle-like performance? There seemed to be a strong consensus that trying to anticipate which companies would become gazelles or even which industries would be the source of gazelles was error-prone, an idea that was expressed in passing by several participants, often by indicating a lack of faith in industrial policy. One or two participants added explicitly that choosing industries was just not how the U.S. tended to work, as opposed to a place like Singapore which would make explicit bets on a small number of industries to provide future growth.

Although discussions over the course of the day suggested some features that were favorable to the creation of gazelles, such as being in a region with a good network of entrepreneurs and dealmakers, the forum did not produce a systematic agreement on the attributes of companies or their economic environments that encouraged gazelles to be born. One of the presenters explicitly expressed skepticism over the ability to predict which companies will be high growth. He pointed out, for example, that discussions with the founders of many of the gazelles showed that they themselves were surprised by their rapid growth. The founder of Potbelly's, a sandwich chain, claims that he just wanted to make sandwiches, but had no idea that the concept would take off as it did.

There is an important underlying question relating to this. To what extent are "gazelles" accidental by-products of random changes in the economy and markets? Only 5-6% of firms are gazelles, according to one of the presenters, and their period of strong growth tends to last only about four years<sup>1</sup>. This is a low enough percentage, and a short enough period of time, that it is likely that some of the gazelles just got lucky. If 100 firms exist in an economy and are positioned in different ways and pursuing different strategies, some of those combinations of strategies and economic positions are bound to be quite favorable over a four-year period. For example, it would be hard for a real estate or housing-related firm to have done badly during the build-up of the housing bubble. Many of these firms are likely to have shown quite strong growth, which does not appear, in retrospect to have been primarily due to any innate superiority. In fact, one of the participants raised the question as to how strongly the data were affected by the "FIRE" industries (Financial, Insurance and Real Estate-related), with the

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<sup>1</sup> The research analyzed small businesses that experienced high growth over a specific four-year period. It found that the large majority of these firms did not experience high growth in the preceding or following four-year periods.

implication that growth of employment in this area, and its subsequent destruction, could distort the figures compared to underlying economic trends of longer duration.

The forum participants seemed fairly united in the belief that gazelles were not purely random. This observation was implicit in their statements about what helped and hurt gazelles and their policy suggestions. No evidence was directly provided at the forum related to the question of random versus non-random factors driving the creation of gazelles.

Fortunately, policymakers can help create the conditions for gazelles to arise and flourish even if we do not know in advance what industry they will be in or some of their other key characteristics. Assistance with funding, knowledge, contacts, and other essential resources can aid existing and future gazelles, often while aiding Main Street small business at the same time. For example, improving the ability of lenders and other providers of capital to channel money to companies with good business plans to grow their businesses should benefit the economy and employment levels, even if the government itself makes no assumptions about which companies are likeliest to succeed.

For completeness, it should be noted that several participants, as described later, seemed to suggest that a few select industries, such as biotech manufacturing or green energy industries, were worthy of special support, although they shied away from the term “industrial policy.”

### **What barriers exist that block high-growth small businesses?**

A main focus of the forum was the identification of barriers to high growth for small businesses, on the presumption that a barrier could often be removed or reduced once it was properly identified. Many different barriers were offered as candidates by various participants:

#### *Problems with funding*

Not surprisingly, a number of the barriers described by participants revolved around difficulties in obtaining adequate funding at a reasonable price, including:

**A dearth of venture capital financing.** One of the presentations highlighted the difficulties in obtaining venture capital financing, a theme that was echoed by many of the other participants. It was generally acknowledged that venture capital financing is only relevant for a relatively small portion of potential high growth businesses, but some pointed out that those firms tended to be the ones with the greatest potential. For example, the firms that eventually grew to the point where they could do IPO's had generally accessed VC financing much more than the average small business, even among high growth businesses.

The venture capital market today exhibits several critical problems. First, it is of relatively small size compared to the potential opportunities. (One presenter indicated that only 2700 companies are funded each year, even in part, by VC funds). The dollar value of VC deals funded, for example, is about one-fifth of the size of its peak at the time of the tech bubble. While that may have been considerably too large, the consensus was that the current size was too small. Second, many of the participants believed that the VC market missed a high portion of potential investment opportunities by where and how they looked for investments. This is despite a general belief in the VC community that they were doing a good job of offering financing to the most worthy firms. Third, VC firms increasingly have focused on larger and later-stage ventures,

making it more difficult for companies to survive and thrive in the critical early stages. Several participants referred to the “missing middle” of small businesses that are large enough to need significant funds, but not large enough to obtain VC or bank financing easily.

One of the presenters explained why VC funds were having more trouble raising money to invest. Pension funds, for example, have lost a great deal of money as a result of the decline in the financial markets and they have also become more risk-averse, both of which push them away from investing in VC funds. Other institutional investors are going through similar recalibrations of their investments. In addition, the performance figures for VC funds have declined considerably over recent years, which make potential investors fear that the best days of VC investing are in the past.

The same presenter acknowledged that access to venture capital was a problem in some geographies and industries, but was not in others. For example, the National Association of Manufacturers believes it is a major problem for their companies. The presenter is also aware that green energy companies encounter this as a major obstacle and some have had to move to China, where support was more readily available.

**Declines in bank lending, particularly to small businesses.** There is plenty of anecdotal evidence that small businesses are experiencing a credit crunch in which some good projects are being turned down that would have been funded in normal times. Recent Federal Reserve surveys of senior loan officers show that until recently banks continually tightened credit standards to businesses of all sizes as a result of the financial crisis. In addition, the limited lending data available suggest that small businesses have experienced a decline in commercial & industrial lending. One of the government’s representatives at the meeting described the focus they have now placed on encouraging more bank lending. He acknowledged that there is a pullback in certain pockets of the banking market because of unrelated problems at community banks that lost large sums in the commercial real estate area and have limited balance sheet capacity. Many small business loans intended for business expansion have real estate assets as their collateral, so the problems in this area also have a very direct effect on the ability to borrow for growth. In tandem, some banks report a decreased demand for loans, as well as a decreased ability to borrow due to deteriorating creditworthiness.

#### *Overall economic conditions*

The current economic troubles were raised as an issue by a number of participants.

**Current financial and economic uncertainties.** One presenter suggested that there is at least circumstantial evidence that entrepreneurs and would-be entrepreneurs are holding off on growth plans as a result of the current questions about the future of the economy and of the availability of financing. Entrepreneurs take calculated risks, as another participant noted. They dislike risk, but take it when the reward outweighs that risk. This fits with the notion that uncertainty on fundamental questions of the economy increases the risk without necessarily raising the potential reward, which should discourage risk-taking at the margin.

**Lack of “effective demand”.** One presenter felt that a key barrier at the moment to small business expansion was simply the low demand for products and services during the recession and its immediate aftermath that we are still experiencing.

## *Government policies*

Several participants directly focused on government policy actions, including:

**Slowdown in policy actions to aid entrepreneurship.** One of the presenters indicated that a Congressional staffer, at his request, had counted the number of pieces of legislation in the 1990's to promote high tech firms. She found 45 of these, which the presenter felt was a large number. He wonders whether we slowed down on these actions since then, which ties in with his mention earlier of Sarbanes-Oxley and other legislation that he believed increased the uncertainty faced by entrepreneurs. On a related issue, Martin Baily noted that the financial reforms, on which he has focused much of his time in the last year or two, are intended in part to reduce excessive risk-taking, but that it would be a shame if this spilled over to the entrepreneurial ranks, where risk taking is often a necessary part of success.

**Uncompetitive tax policy.** A number of presenters described U.S. tax policy as a significant barrier, especially when viewed in a global context, as described further below.

**Difficulties in accessing government-supported funding.** Several participants described excessive hurdles, such as a lack of coordination resulting in what seemed to be an unnecessary number and diversity of applications, that they felt were put in the way of accessing funding supported through the SBA and other government agencies. One participant with experience as a funder emphasized that “complexity is the enemy of transactions” and suggested that problems in the application process were creating excessive complexities in obtaining government funds.

### *Issues around “social capital”*

One of the presenters described at length the strong social networks that existed in certain geographic regions that appeared to substantially assist in the growth of innovative businesses. These networks were built around entrepreneurial dealmakers who served as the nodes of the network, forming connections among series of entrepreneurs and investors.

Another of the presenters indicated in the Q&A period that he believed that “social capital” is increasingly important in innovation and that there is a mismatch between where the knowledge is and where the right people are. Many of the participants described barriers that fell into the broad category of social capital issues, including:

**Access to decision-making information.** One participant focused particularly on the need among many entrepreneurs for better information and advice about how to tackle the different problems that arise at different stages in the development of firms. Karen Mills backed this up by describing how companies who have taken advantage of a long-term counseling relationship with the SBA have higher growth than companies that do not, which she attributed to the better access to decision-making information.

**Failure to sufficiently include minorities and other underserved communities in social networks.** One of the participants is part of an effort to put together an organization at the national level for people of color, because they have been seriously under-represented in high

growth industries. Although this was not explicitly stated, such under-representation presumably filters out a number of high growth companies that could have been built if there had been more social capital to draw upon. Another participant stated that many of the businesses in the “missing middle” which do not get sufficient support are owned by women or minorities and often exist in lower or middle income areas in both urban and rural America.

**Failure to effectively commercialize university research.** Several participants suggested that academic research is not moving into commercial settings as well as it should be. One participant indicated that a conference convened by Secretary of Commerce Locke had shown a broad consensus amongst universities that they would like to partner more with the government and private sector to encourage growth, but that there are difficult issues involved.

**Lower worker mobility.** One of the participants believes that the geographic mobility of our American workers, which has always been a strength, has declined somewhat. This decline is probably due in part to an aging of the population and in part due to the current difficulties in selling a home in order to move elsewhere. There are likely other factors as well.

**Too many bankers, too few engineers and entrepreneurs.** Several participants asserted that the period since the tech bubble burst had seen a diversion of talent from entrepreneurial activities into Wall Street. There is plenty of anecdotal evidence that scientists and engineers were pulled to Wall Street by the high compensation levels and the excitement of a booming market for exotic financial products. Some suggested that these talented, hard-working people might have made a more positive contribution to society by working in start-ups outside of the finance area.

One of the presenters felt this brain drain was particularly unfortunate, because he sees individual entrepreneurs as being critical to successful start-ups. He indicated that Venture Capital (VC) firms say that to build a \$1 billion revenue business, you need a founder with the right skills who is willing to work 100 hours a week for 7 years. He stated that “if you can’t get your best and brightest to be entrepreneurs, what the rest do really won’t matter.”

This view, which is quite widely held by policymakers, was questioned by other participants, including, but not limited to, those who work or worked in the financial industry itself. It was noted that actually proving this viewpoint would be quite difficult. It would have to be shown that the particular trained individuals would have been effective in a non-finance area and that they would have gone into entrepreneurial activities, absent the lure of Wall Street. It also requires the assumption that their contributions in finance were negative or less positive for society than would have been true in the entrepreneurial environment. One of the participants felt that a lot of smart, trained people would not make great entrepreneurs and a lot of great entrepreneurs had not made great students. Another participant noted that two National Science Foundation studies had shown that scientists and engineers are often not going into directly related work. Thus, it is unclear how much Wall Street caused a brain drain from the sciences and how much there was a lack of jobs in science and engineering for the trained people to go to.

**Lack of sufficient cultural support.** One of the presenters has developed a database of information relevant to entrepreneurship for 70 countries. He believes that U.S. innovation, entrepreneurship, and resulting employment growth seemed to work better than in the rest of



the world in the 1990's. However, his current data suggests that we are now number 8 out of the 70 countries in our ability to support innovation. Much of what keeps us from being number 1 appears to relate to insufficient cultural support for entrepreneurship. He did not have time to elaborate much on what constitutes cultural support.

#### *Other types of barriers*

**Shortage of good tech ideas.** One of the participants suggested that technology opportunities did not represent a continuous function, but that instead they come in waves. He wondered whether we “hit an empty bucket there” which partially accounts for the apparent slowdown in new, innovative business start-ups. He asserted that a lot of VC companies say they are ready to invest, but cannot find anything to invest in.

**Global competition.** A number of participants discussed the problems resulting from increasing global competition for good projects and entrepreneurs.

One presenter focused on biotech manufacturing and showed how certain countries were taking advantage of inherent advantages, such as the presence of related industries or government support, to build biotech manufacturing sectors. This presenter talked particularly about the importance of tax policy, where the U.S. has become relatively less friendly as other countries have reformed their corporate tax codes.

Another presenter, and several participants, raised another side of globalization, which is that many entrepreneurs can choose between starting a business here, in their home country, or in another, more hospitable, country. This is particularly problematic at times when the U.S. makes it harder for entrepreneurs to come here to start their companies.

A third form of global competition is for capital. One of the presenters confirmed that there is a trend towards more VC money going overseas, because of the attractive opportunities in some of the high-growth countries. Another asserted there was “an exponential amount” of venture capital leaving the U.S.

One of the participants made the point that the U.S. is not necessarily getting worse in absolute terms in our support of entrepreneurs, but that other countries have imitated some of our best approaches and have otherwise raised their game, eroding our relative advantages. Martin Baily seconded the point that we still have real strengths in the entrepreneurial area by talking about the envy expressed by German colleagues at the innovation clusters created around universities like MIT.

**Problems in the education system.** Several participants alluded, often in passing, to the difficulties businesses sometimes have in finding employees with the right training. The problems appeared to be at the technician level, where straightforward vocational training could help, rather than in terms of highly skilled workers.

#### **What should be America's policy goals for small business?**

Throughout the course of the day, a common theme came up in the questions from participants. In fact the very first participant to ask a question that morning put it very well: “what are the variables we are trying to optimize?” Put another way, if the goal for the process started at this

forum is to improve public policy regarding small business employment and other economic conditions, what would constitute “improvement” and how would we measure it?

Clearly, increasing the number of jobs created each year by small business, net of job destruction, would, all else equal, be viewed positively by all participants. However, the “all else equal” part of that formulation is highly significant and hides a number of potential measurement issues. In particular, small business jobs are only part of the universe. It could be that small business jobs are being created by the dis-integration of larger firms. For example, if a large company decides to spin off an administrative unit and then contracts with it to perform the same functions, this is a clear increase in the number of jobs at small businesses, but not necessarily a gain for the larger economy. If the business decision is good, the new unit might turn out to be a gazelle that grows rapidly by taking on work from other employers. If it is bad, the separate unit may founder and effectively have served primarily as a downsizing of the larger company. Even more basically, supporting small businesses that gain market share, and related employment, by taking it from larger businesses may be a good thing. However, it could also represent a mere reshuffling of jobs, if the small business is gaining share principally as a result of subsidies rather than as a result of superior business practices.

This process of spinning off and outsourcing tasks from large companies to small businesses should not be confused with the somewhat overlapping concept of “creative destruction.” To the extent that movement of jobs to small business from large contributed to a shift towards more productive firms, this would clearly be a good thing. The preceding paragraph is merely intended to make clear that small business is only part of the employment universe and that all parts need to be considered in judging success.

We presumably also care about more than simply the number of jobs. Several participants spoke positively of different initiatives by emphasizing the “quality” of the jobs, such as the high average compensation levels in biotech manufacturing. Others mentioned ways in which initiatives were bringing jobs that could be filled by laid off textile workers or others who might otherwise only find low-paying jobs or remain unemployed in the absence of the new industries. Thus, job creation could be better if it brings higher compensation or creates relatively “good” jobs. Of course, this concept could conflict with other job creation goals. For example, does encouraging higher-paying jobs place new jobs out of the reach of the less fortunate?

Other participants spoke of “spillover effects,” particularly in more sophisticated and research-intensive industries. This does not contradict any of the other measures, but reminds us that some businesses produce more of what economists call “positive externalities” than do other businesses. This was shown most graphically in one of the formal presentations which mapped how networks of dealmakers and businesses could work together to create yet more opportunities in a community. This is doubtless one of the explanations for why certain regions produce more gazelles than do others.

Another nuance to keep in mind is that while one tends to focus naturally on increasing job creation, the reduction of avoidable job destruction has the same effect on net employment. Of course, as one presenter emphasized, clearing away the deadwood by allowing job destruction at worse-performing firms is essential to the proper reallocation of resources in the wider economy. So, the trick would be to raise the quality of the marginal firms so that their improved performance allows them to retain employees they would otherwise have to let go.

Finally, there is always a second variable involved when discussing optimization in public policy. What are the resource constraints? A key factor to consider is the cost to the taxpayer. In practice, this would probably be measured as the subsidy cost shown in the federal budget. (Even here, there is disagreement among economists and policy analysts as to whether those subsidy costs are correctly calculated.) However, one could also attempt to measure the costs to the larger society that fall outside of the federal budget. For example, research has shown that subsidizing one activity may raise the cost of providing another. There may be yet other factors to consider, such as the availability of personnel with a sufficient level of expertise or budget limits on the volume of loans or guarantees that may be offered.

The forum agreed that reaching consensus on the critical question of goals should be given priority either at the next session or in advance of such a meeting.

### **What are our initial policy suggestions?**

While the focus of this working session was on sharing information regarding high growth small businesses and identifying some of the barriers these businesses face, there was some discussion of potential policy options to pursue. There was not a strong consensus in the room on the best policies to pursue, but rather a wide range of suggestions, generally focused on eliminating or mitigating the effects of the barriers described in the preceding section. In addition, there were quite a number of participants who urged that actions be geared towards increasing the general dynamism of the economy and of the small business sector. The implicit message was to focus less on very specific problems and more on improving the flexibility of the economy, encouraging normal market mechanisms to transfer the resources away from poorly performing firms to those with better performance and growth potential. Although there appeared to be strong agreement in the forum on the general importance of increasing the dynamism of the economy, specific policy discussions in this area appeared to lie outside the scope of the day's mission. For example, reducing the level of uncertainty stifling entrepreneurial activity or increasing productivity in the economy would both clearly be good things, but each could have merited a full session in its own right, given their complexities. Again, as stated in the introduction, while the content in this document reflects the views of the participants of the forum, none of the opinions presented or policy solutions proposed in the document have been endorsed by the SBA, the Obama Administration, or Brookings, except where explicitly stated.

One participant raised the important question of the time frame for the policies to be proposed. The response from Karen Mills and Martin Baily was to consider both short-term and long-term approaches, with the caveat that policies to increase aggregate demand were not the focus of the forum. Another participant raised the general point that until we knew how to define a high growth company, it was going to be difficult to design effective policies to support them. He went on to suggest that the best place to look for high growth companies was in the 10-100 employee range, with at least \$1 million of revenue. (This suggestion was consistent with a frequent comment that there was a "missing middle" of companies in this broad size range that was not receiving sufficient support from the private and public sectors.)

**Providing government support to high growth industries.** This was a particularly controversial idea that was touched on in one way or another by many of the participants. Everyone who addressed this topic seemed leery of old-fashioned "industrial policy," but many participants

explicitly or implicitly suggested an industry or type of industry which might merit special treatment. Green energy was cited several times and biotech was the focus of one presentation. Although no one suggested specific government support, there was a strong implication that there should be a particular emphasis in these areas. One participant stated that “no one wants to talk about industrial policy, but we need to understand what the industries are and where there is growth”. She added, “I would like us to keep in mind a broader perspective for how we set the stage for picking winners in particular industries where we do have a competitive advantage.”

On the other side, many participants explicitly argued against trying to pick industries. It was stated a number of times that we cannot tell in advance which industries would take off and which would flag. Others stated that the US government did not typically do this type of focused industrial support, at least as a general rule.

**Provide more funding for existing government programs.** There appeared to be broad, implicit agreement that this could be helpful, but the focus of participants’ comments were much more on adding new programs or improving the effectiveness of those that already exist.

#### *Improve access to funding*

A large number of the participants cited funding problems as a major barrier to small business growth. Karen Mills agreed and emphasized the particular funding problems for businesses with \$2-20 million of annual revenue.

**Improve access to venture capital.** Many participants described serious limitations with venture capital, including: insufficient availability of funds in total; biases away from the early and middle-stage financing that is most needed; a related bias towards the larger end of small business; and a myopia that caused VC investors to miss many kinds of opportunities in many geographic regions and industries. One concrete suggestion that several participants endorsed was to grow the Small Business Investment Company (SBIC) program by which the SBA matches private investors who create funds to invest in small businesses. There may be a series of other policy actions that could spur private VC funds to see the opportunities that they are missing today. Perhaps there is a way to systematically bring business plans and entrepreneurs from neglected geographies and business sectors together with VC investors.

**Improve access to bank lending.** Similarly, many participants identified limitations in the bank lending market that are hampering entrepreneurs. This is a particularly acute problem today because many of these business people had gotten around bank restrictions in the past by pledging residential or commercial real estate as collateral or buying supplies and equipment on their credit cards. The plunging availability of credit through cards and mortgages has accentuated a credit crunch that would likely have arisen anyway at this point in the economic cycle. The Administration is well aware of these problems and has proposed creating a \$30 billion fund to infuse capital into smaller banks that are willing to step up their small business lending. (This is in addition to well-known, and very large, efforts to restore the health of the private sector financial institutions to put them in a position to lend.) Finally, government programs are being ramped up to provide additional support for the missing private sector credit, as explained next. There were no other policy suggestions in this area raised at the forum.

**Improve access to SBA and other government funding.** Under the American Recovery and Reinvestment Act, SBA has already increased its government guarantee and reduced fees on its two largest loan programs. In addition to continuing these measures, the Administration has already proposed an increase in the maximum loan size in several programs to support greater loan volumes. Options to build on these proposals would include increasing these levels still further or expanding the points of access to SBA loans through additional lending partners. Another option would be to do a better job of leveraging private funding, such as the suggestion from one of the presenters that SBA-supported equity investments could be interleaved more effectively with private money, including locking in the funding for the affected businesses, subject to trigger points in terms of size or profitability.

**Enhance other funding sources.** A large number of participants, including Karen Mills, highlighted the difficulty in finding early stage funding for innovative businesses. Some of them expressed a need to improve “angel investing” or to find another source of funds equivalent to this. However, no specific policy suggestions were raised at the forum. Similarly, one of the participants described the need for more “growth capital,” funding for entrepreneurial businesses that would not involve equity ownership, which most entrepreneurs are loath to give up. There is a market for “mezzanine” financing, but it is quite limited, as indicated by the participant’s remarks. No specific policy suggestion was made as to how to lure such investors without the benefit of an equity stake.

#### *Education and research*

**Improve education, especially to meet the specific needs of growth industries.** Educational deficiencies were listed by several participants as barriers, which raises the logical question of whether policy actions could directly assist in this area. None of the participants, however, explicitly voiced suggestions here, although lack of good vocational training was mentioned as a specific barrier and therefore may be a fruitful area to consider.

**Enhance the commercialization process for academic research.** Several participants cited a need to improve the manner in which academic research was brought to the commercial market. No specific suggestions were raised in the forum, but there have been recommendations elsewhere. For example, the Kaufmann Foundation has published a paper recommending that legislation free academics from being tied to their specific university commercialization programs, which would force competition among these programs.

**Increase support for innovative research to help “fill the bucket.”** One of the presenters expressed a concern that perhaps we were between waves of innovation and that the bucket of innovative research was simply “not full” at the moment. Another participant had emphasized the important role that the National Science Foundation and other government programs have played in spurring the basic research that eventually led to commercial advances. Combining the two points suggests that one policy option would be to provide still further support for basic research, which has already been supported by the Administration. Alternatively, it may be worth exploring whether support for research in “softer” areas than the sciences might do an equal or better job of inspiring commercialized innovations.

#### *Meeting the challenges of globalization*

**Make tax policy friendlier to high growth businesses.** A number of participants felt that corporate tax policy in the U.S. now placed us at a relative disadvantage, in contrast to earlier decades when we had a relative advantage. Two specific ideas that were raised were to increase the level of tax credits for research and development and to further lower the taxation on capital equipment. Of course, another idea that has received considerable attention, although it was not raised directly at the forum, is to lower taxes on employment in order to directly encourage more jobs. This would seem particularly relevant to high growth small businesses, which historically add the most jobs to the economy.

**Focusing VC money on the U.S.** Several participants described how venture capital money was increasingly being invested in emerging market countries rather than in America, even though the funds are based, and the money is raised, here. No policy suggestions were brought up to deal with this, but there could be tax or other policies that would keep some of this money in the U.S. That said, there are advantages to having American money invested where it will make the highest returns, and global growth aids us as well, so there would need to be a careful cost-benefit analysis of any such policies.

#### *Building Social capital*

**Encourage regional clusters of innovation.** Some of the presenters and many of the other participants stressed that some regions do a better job than others of encouraging innovation. Silicon Valley is the classic example, but one of the presenters had identified 40 regions in the U.S. which were clusters of innovation. A number of participants emphasized the importance of assisting in the creation and expansion of such clusters of innovation, although they did not suggest particular policies at the forum.

One participant referred to a conference convened by Secretary of Commerce Locke on the important role of universities in fostering innovation. Another participant referred positively to the Massachusetts technology initiative to support innovation. Finally, Karen Mills discussed the recent \$129.7 million Energy Regional Innovation Cluster program that is being implemented by the Administration. This is coordinated by the Department of Energy in cooperation with 6 other departments and agencies, including the SBA, to spur regional economic growth while developing innovative energy efficient building technologies, designs, and systems.

There would also be room for encouraging entrepreneurial networks in communities which would never have the scale for a truly regional network. No specific policy options were suggested here, other than enhancing the counseling programs available through the SBA.

**Take advantage of the potential of immigrant entrepreneurs.** One of the participants particularly highlighted the need to remain open, indeed to be more open, to immigrants who want to establish entrepreneurial businesses in America. He cited the current legislative proposal for an entrepreneurs' visa as an excellent step forward. He acknowledged the political difficulty that immigration at a time of high unemployment is seen by a segment of the public as "taking jobs away from Americans," but urged the view that this was quite the opposite situation in reality. New businesses would create jobs for Americans even if the founder initially came from outside the country.

**Enhance growth counseling.** Karen Mills underlined the success of the SBA's growth counseling programs, but also felt that they could be expanded and made more effective, by better distinguishing between "mom and pop" and high growth businesses, for example. Several participants encouraged a still greater emphasis on assisting minorities and women. One participant lauded the SBA for its help with African Americans, but indicated that these entrepreneurs could use more help in learning how to win private contracts after they cut their teeth on government contracts. On a more general topic, another participant suggested that perhaps the advice for small businesses could be "stacked" just as the different funding sources were stacked over time, so that a growth phase that would require new funding would also bring new advice.

**Incentivize more people to become entrepreneurs.** There was a general feeling among many participants that a large number of potential entrepreneurs failed to take this path and that it would be good to encourage them to create and build businesses. No policy actions were suggested during the forum specifically targeted to this issue, although actions to improve the "social capital" available to entrepreneurs, particularly in underserved communities, including better access to decision-making information and stronger regional clusters would presumably encourage more people to take a chance on building a business.

**Increase "cultural support" for entrepreneurship.** A number of the other measures suggested here would touch on the cultural support issue. However, there was not time for much direct discussion this set of points. It might be a fruitful area for further research.

#### *Other policy suggestions*

**Improve process and coordination among government agencies.** Karen Mills emphasized that this Administration places a high priority on coordination across government departments, which is why they are doing increasing numbers of large, cross-department initiatives. One of the participants suggested an approach analogous to the economic crisis response centers he had seen in Puerto Rico. In that case, all of the relevant government agencies were brought into a single large room so that someone who was newly unemployed could easily access each of the potential sources of government help. A similar approach might aid small businesses who are looking for funding or other assistance.

**Increase government contracts for small business.** Several of the participants indicated that the reduction in "effective demand" caused by the overall economic crisis was a major reason for the drop-off in job creation by high growth companies. One potential policy action that did not come up at the forum was to increase the proportion of government contracts going to small businesses, at least temporarily. The SBA is responsible for working with Federal agencies to ensure that the federal government meets its statutory goal that 23 percent of federal government contract dollars go to small businesses.

**Stronger legislative focus on entrepreneurialism.** One of the presenters discussed what he suspected was a significant decline in legislative initiatives designed to help small businesses to grow. A logical implication would be to refocus on this area, although he did not offer specific suggestions in this regard.

#### **Research questions to be answered**

There are a number of research questions that arose during the forum or as a clear implication of those discussions. There is doubtless already research in many of these areas that should be brought to bear in the small business discussions. In other cases, these would be new research topics.

- What has been the pace of innovation over the years? Has it slowed down this last decade?
- Can we identify in advance some characteristics of high growth companies?
- Why are more scientists and engineers not going into the professions for which they are trained? Are they using their skills effectively in the professions in which they do end up?
- How much of the growth of small business is the result of the dis-integration of larger companies?
- How has globalization affected the formation and growth of gazelles?
- What is the competitive position of the U.S. for high growth industries? Do gazelles develop differently in foreign countries?
- Is there a shortage of entrepreneurs?
- To what extent is access to capital a problem?
- How has labor market flexibility changed?
- Why has the average number of jobs at a newly created business dropped from about 4.5 to about 4?

## **Conclusions**

The forum brought together analysts, decision-makers, funders, and practitioners to focus on how the SBA and other government agencies could encourage high growth small businesses. The participants had a chance to share their understandings of the background issues, the known facts and the holes in the data, and the key policy goals. They were able to begin discussing some interesting policy options.

None of these tasks could be fully achieved in the course of a morning, but the ground is now prepared for further fruitful discussions. In the meantime, it would be useful to do a literature review on the open questions from the forum, since many of the points have been researched already. Equally importantly, the policy goals, and initial suggestions, can be put into a tentative framework to encourage further analysis and discussion.