

WHY WASHINGTON HAS IT WRONG

Government policies treat every small company the same. But...

A handful of startups have the biggest impact

Most small companies stay that way

- Just **6.3%** of companies in the U.S.—almost all of them small firms—created all net jobs between 1994 and 2008, a study for the Small Business Administration found

- On average, these firms created a total of about **10.7 million** jobs in every four-year period studied from 1994-2008

- Every one of these firms had their sales double—at least—over four years

- As a whole, they also delivered more productivity than other companies, as measured by revenue per employee

Source: "Accelerating Job Creation in America: The Promise of High-Impact Companies," by Spencer L. Tracy Jr., Corporate Research Board LLC, for the SBA Office of Advocacy

- **2 out of 3** small firms are ventures that likely won't grow big, from plumbers to lawyers to shopkeepers

- In fact, **75%** of small-business owners aren't looking to grow big

- All told, only **8%** of new firms reach 20 employees within 10 years

- Just around **10%** of new firms say they're looking to create their own technology or other innovations

- Almost **85%** of small firms don't get a patent or other protection in their first four years

Source: "What Do Small Businesses Do?" by Erik Hurst and Benjamin Wild Pugsley, Brookings Papers on Economic Activity, fall 2011



BY AARON CHATTERJI

It's time for the government to get a lot smarter about small-business policy. In an era when political battles are nastier than ever, small business is the American dream we can all agree on. Democrats and Republicans alike line up behind the idea that small firms are job creators—the backbone of the economy—and they deserve a helping hand from the federal government.

Yet we're not doing all we can to support them—because we're treating them all exactly the same.

It's obvious that small businesses are incredibly diverse, with very different needs, aspirations and potential. The government, though, lumps them all into one category, covered by the same rules, policies and federal agency. Generally speaking, if you have fewer than 500 employees, you're a generic "small business"—whether you're the dry cleaner who's been on the same corner for a decade or a tech company that just launched in a dorm room.

It's easy to see why we take a cookie-cutter approach. The Small Business Administration opened its doors in 1953, long before the en-

trepreneurial revolution of the 1990s, and is designed to meet the needs of more-traditional small businesses. Most of the agency's loans go to aspiring restaurant owners and hotel franchisees, not companies that come up with ideas that can reshape the global economy.

Traditional small businesses are important sources of jobs in every community. But startups with big potential need different kinds of assistance to thrive—and we need them to thrive, especially in today's economy. The one-size-fits-all approach just doesn't make sense any more.

Growth Is Rare

Take this simple fact: Small companies create enormous numbers of jobs, but those gains are driven by a handful of startups that actually grow big. Most small businesses start small and stay that way.

Less than a quarter of America's 27 million small businesses have employees. An even smaller portion grow beyond 20 employees. And many of them don't want to. New research from the University of Chicago finds that 75% of small-business owners aren't aim-

ing for growth at all. They're basically just looking for a steady job as their own boss.

Compare a venture like Facebook to your neighborhood hardware store. Both of them launched with a handful of employees in tight quarters. But while your hardware store offers a useful service and creates jobs—most important, for the owners themselves—it's unlikely to have the same wide-ranging impact that a promising startup could. Think of how many other ventures have come into being because of Facebook, or how it has created whole new markets and changed the way companies large and small do business.

Yet the government has traditionally placed the neighborhood store and the high-potential startup in the same catchall category. It offers them the same loan programs, counseling services and other assistance. And that means lots of small companies, not to mention the economy as a whole, get short-changed.

Missing the Distinction

For instance, the government might institute a tax credit for hiring new workers. That's of great importance to a local company

like a nail salon that might be on the fence about taking on an employee.

But high-potential startups often aren't as worried about how to pay for workers; they're concerned with finding high-skilled employees, whatever the cost. So they're more focused on issues like immigration reform and science, technology, engineering and math education.

The trouble is, their designated advocate, the SBA, doesn't have the final say on these matters or other high-priority items like patent and capital-markets reform. The responsibility for these issues is instead spread across many government agencies, none of which is thinking of high-potential startups first.

Or take an initiative like the Small Business Innovation Research program, which awards over \$2 billion in grants to help businesses commercialize innovative research. For years, the program was closed to startups that receive the majority of their funding from venture capitalists. The idea was that these firms would have an unfair advantage over other small businesses.

But the venture-backed companies are *exactly* the ones the government should be supporting—they've already been validated by outside investors and have the potential to grow and help the economy.

After an intense lobbying effort in Congress, the program was opened to majority venture-backed firms. But these situations are bound to crop up when two very different

Please turn to the next page

For starters, policy makers should ask a simple question: What is a small business, anyway?

Dr. Chatterji is an associate professor at Duke University's Fuqua School of Business and a former senior economist at the White House Council of Economic Advisers. He can be reached at reports@wsj.com.

THE READERS WEIGH IN

■ What's the best thing government can do to help small business?

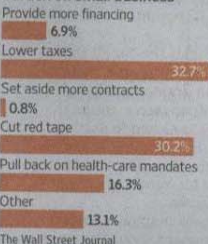
Boosting small companies is one of the few things the two parties can agree on. But plenty of business owners think the government could do even more—whether it's lowering taxes, slashing red tape or generally getting out of the way of small companies.

Stop protecting the big guys. If you refuse to let big companies fail, there is that much less room for small businesses to grow. To make it worse, the government is subsidizing failing big companies and giving them even more advantages over the small guys.

FLS

A Lighter Touch

Many respondents want government to ease the burden on small business



Fill the pipeline with successful entrepreneurs by requiring entrepreneurial training in high school: financial statements, spreadsheets & formulas, proforma preparation, financial modeling, marketing, project management, etc.

Mariah

The government needs to tell its commercial lending regulators to back off SLIGHTLY and give internal underwriters the room to allow a little risk in the bank's commercial loan portfolio.

James R. Griggy

The certainty of regulations and taxes—it's currently very difficult

to budget (without knowing what changes will happen next year).

Mark

Provide government-based single-payer health care.

Gionass

The government should do as follows:

1. Shut-up, a large majority of politicians have NEVER owned a business;
2. Get out of the way and do what they do best—NOTHING;
3. Rather than how to the demands of unions and lobbyists—seek out small business owners regardless of political party—ask, listen, and go to work to help them;
4. Drop partisan interests—bottom line—we are ALL Americans who seek the support of our elected officials to be an alliance for our community, not to determine our fate based on party platforms, favors owed, or personal gain.

Ashleigh Alexander

A major reason why an entrepreneur does not take the leap to start a business is because of existing patents on common sense solutions or processes. Our government needs to reform the patent approval process, as it stifles business creation and innovation.

Chad

The best they can do is leave small businesses alone.

Chico

Why Washington Has It Wrong

Continued from the prior page
kinds of firms, with different attributes and ambitions, are competing for the same pot of money.

Another distinction that gets lost under the current setup is age. Research indicates that the lion's share of jobs created by small business actually come from new startups, between one and five years old, the very best of which grow into global businesses. But the SBA's flagship 7(a) program provides roughly two-thirds of its loans to existing businesses, not startups. This is because SBA loan programs work by guaranteeing loans from commercial banks, which are often reluctant to lend to unproven startups.

Older companies need financing, of course—but they usually don't have the potential for explosive growth that startups do.

Time for a Split

What's a better approach? Make sure local businesses with more-modest ambitions and dynamic startups both get the customized attention that they deserve.

To be fair, Washington has taken some steps lately to target assistance to different types of small businesses—the recent bipartisan JOBS Act and the Startup America initiative led by the White House and SBA. All of that is helpful and encouraging. But it doesn't fix the underlying problem: We need a fundamental change in how we define—and address—small companies.

For a start, our public policies should recognize that some small businesses are built for rapid growth while others are likely to stay small forever. Firms that are young, say five years or less, and exhibit potential for rapid growth and innovation should be classified differently than older firms that are less likely to grow and add jobs. Let's call that former group "startups" instead of "small businesses."

That simple definition change can make all the difference. The SBA would continue to provide its valuable loan programs and other services to small businesses that are likely to remain so. The high-growth-potential firms identified as startups would get customized attention from a team of advocates drawn from across the government—the White House, Treasury, Commerce and other relevant departments, including the SBA.

This structure would ensure startups receive high-level attention from the various agencies that impact their fortunes. And having the SBA play a prominent role also recognizes that the line between startups and small businesses won't always be clear.

The interagency team could, for instance, recommend sensi-

ble reforms to our high-skilled immigration policy, improvements in intellectual-property law, better-designed grant programs that push innovative ideas from universities into companies, regulatory reform around the approval of drugs and medical devices, and policies to sustain a robust venture-capital industry and investments in science and math education.

While formal authority on particular issues, such as immigration policy, would still lie with the home agency, this group could better coordinate activities and pool resources. Most important, startups would have a single, exclusive point of entry to our federal government and attention from cabinet level officials.

Startups might then get targeted tax incentives and grants to help them reach their potential. This kind of credit could cost the government less revenue and deliver bigger results than a broad-based incentive aimed at all small businesses.

A Far-Reaching Effort

While the government looks at new ways to help startups, it can also look at smarter ways to support the other category of businesses—the traditional small businesses that will remain under the charge of the SBA. For instance, given the boom in businesses that are run out of people's spare rooms, the government might consider redesigning the home-office tax credit. For those small businesses seeking to grow, the government should help them along by procuring more goods and services from them and reducing the costs of exporting to new markets.

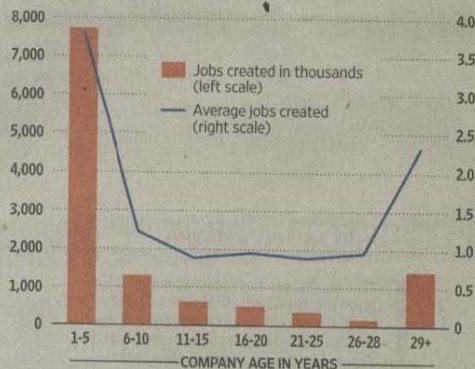
This new division of "startups" and "small businesses" should also be part of a broader mind shift among policy makers. Right now, we look at the raw number of new businesses that are launched as a measure of success or failure. But we should instead look at the revenue and jobs these businesses generate—to tell if we're fostering businesses that can expand and help the economy. In addition, whether we are talking about startups or small businesses, let's never forget how hard all of these business owners work every day.

The bottom line when it comes to small-business policy is that we can do better. The right policy agenda will recognize the differences between a small family business, a one-woman consultancy and a venture with the intention and potential to become a billion-dollar enterprise. And then it will give them the customized support that fits their needs.

If we succeed, the American dream, in all of its varieties, will continue to thrive.

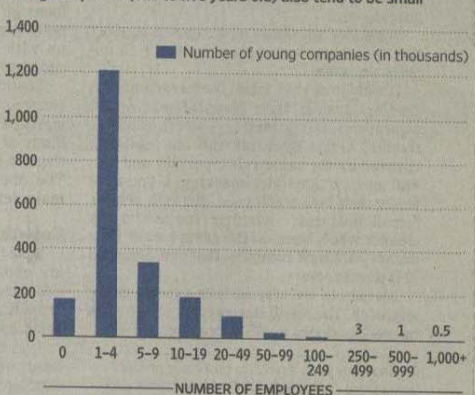
Off to a Fast Start

Young companies create more jobs than older ones, and also rack up the highest average number of jobs created



Note: Annualized net lifetime job creation for companies in 2007

Young companies (one to five years old) also tend to be small



Note: Data are for 2007
Source: Special tabulation by U.S. Census Bureau for Ewing Marion Kauffman Foundation

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