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Tax and Capital Access

The Entrepreneurship Deficit
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Chairman Brat, the Ranking Member and members of the Committee, thank you for the invitation to testify at this hearing about the small business economy.

I'm pleased to share some insights and recommendations from the Kauffman Foundation about the state of entrepreneurship in America. First, I'll describe the bad news. Then I'll share some good news. Finally, I'll talk about how we can address these challenges.

First, the bad news. America is suffering from an Entrepreneurship Deficit. It's slowly but surely eroding our quality of life and our national competitiveness.

I've personally experienced the challenges of starting and growing new businesses. My parents were entrepreneurs. For most of the past decade, I've been an entrepreneur and investor in Silicon Valley. And over the past year, I've gotten a "big picture" perspective as the head of entrepreneurship of the Kauffman Foundation, an institution that funds research on entrepreneurship, educates policymakers, and supports entrepreneurial success.

So what is causing this Entrepreneurship Deficit? Based on our work, we believe the deficit comes from a long-term decline in what economists call business dynamism, the pace at which firms start and grow. As a case in point, Americans are starting new businesses at roughly half the rate they were a generation ago.¹

The implications of this deficit are profound. Recent economic research is starting to show how the Entrepreneurship Deficit is connected to some of America's biggest challenges: slow productivity growth, lower wages, stagnant job growth, and rising inequality. The data indicate that entrepreneurs create economic opportunities for others in society, like a circle in the water that ripples outward, in a continuing process that facilitates upward mobility. And each year, as our research suggests, the new and young businesses started by

¹ Haltiwanger, John. "Top Ten Signs of Declining Business Dynamism and Entrepreneurship in the U.S." NBER, August 2015.

entrepreneurs create nearly all of the net new jobs in our country.² Another recent report expands on the connection between the long-term decline in entrepreneurship and the effect on productivity and growth. That lackluster productivity drags wages and living standards down.

Put simply – fewer startups mean a lower quality of life for Americans.

But there's a gap between what we know and what we do. For the most part, entrepreneurs are left out of the policy debate. Our national discussions tend to fall along the same political fault lines of the past. Meanwhile, entrepreneurship remains far below what's needed.

The Three Megatrends

To make this case, I'd like to highlight some interesting new data. At the Kauffman Foundation, we have identified three megatrends that are reshaping entrepreneurship. We call these trends the New Demographics of Entrepreneurship, the New Map of Entrepreneurship, and the New Nature of Entrepreneurship. These trends present both challenges and opportunities to solving the long-term decline of entrepreneurship.

First, the New Demographics.

The U.S. population is increasingly becoming more racially diverse. Yet, the American entrepreneurial population does not reflect these changes. Today, 80.2 percent of American entrepreneurs are white and 64.5 percent are male.³ That's a big gap for racial minorities and women. And it costs the country.

If minorities started businesses at the same rate as non-minorities, the United States would have more than one million additional employer businesses and as many as 9.5 million more jobs.⁴ The persistent gender business gap has cost our country an additional 1.7 million businesses.⁵

The second megatrend is the New Map of Entrepreneurship.

The New Map is characterized by two things. First, entrepreneurship is increasingly an urban phenomenon. And second, entrepreneurial activity is growing outside the largest metropolitan areas traditionally associated with entrepreneurship—like Silicon Valley.⁶

² Haltiwanger, John, Ron Jarmin, and Javier Miranda. "Who Creates Jobs? Small vs. Large vs Young." NBER Working Paper, August 2011.

³ Morelix, Arnobio, Victor Hwang, and Inara Tareque. "Zero Barriers: Three Mega Trends Shaping the Future of Entrepreneurship." Kauffman Foundation, February 2017.

⁴ Ibid

⁵ Ibid

⁶ Ibid

Over time, America has become a more urban nation. Fewer people live in rural areas today than they did in the past. But for those Americans living outside our nation's largest cities, we need to ensure there is economic opportunity where they live. Entrepreneurship is part of the answer.

The final megatrend is the New Nature of Entrepreneurship.

Technology is changing everything, including entrepreneurship. In the past, as companies scaled their revenue, jobs could scale in almost the same fashion. That is no longer true and will be even less true in the future.

Take for example two businesses that were leading innovators in their day: Kodak and Facebook. In 1962, Kodak's sales first surpassed \$1 billion dollars. At the time, Kodak employed 75,000 workers. When Facebook reached \$1 billion in revenue in 2013, it employed about 6,300 workers.⁷

This is not exclusive to Facebook. This is only one example of what we know from research covering millions of companies and almost twenty years of data: the most innovative, high-productivity companies are not creating as many jobs as they did in the past.⁸

The State of Entrepreneurship

Now, some good news. Earlier this morning, the Kauffman Foundation held its eighth annual State of Entrepreneurship Address, where we assessed the health of American entrepreneurship and launched a new initiative to empower bottom-up change.

There is some positive movement on the short-term indicators. After a long hangover from the Great Recession, entrepreneurship is finally rebounding in the United States.⁹ According to the Kauffman Index of Entrepreneurship Series, entrepreneurship is up across all three measures: new business creation, growth, and local small business activity.

Kauffman's Main Street Entrepreneurship Index, which measures local small business activity, is nearing a two-decade high, driven by a jump in small business survival rates. Today, almost half of all new businesses are making it

⁷ Morelix, Arnobio, Victor Hwang, and Inara Tareque. "Zero Barriers: Three Mega Trends Shaping the Future of Entrepreneurship." Kauffman Foundation, February 2017.

⁸ Decker, Ryan, John Haltiwanger, Ron Jarmin, and Javier Miranda. "Declining Business Dynamism: Implications for Productivity?" Brookings Hutching Center on Fiscal & Monetary Policy, September 2016.

⁹ Morelix, Arnobio, Victor Hwang, and Inara Tareque. "Zero Barriers: Three Mega Trends Shaping the Future of Entrepreneurship." Kauffman Foundation, February 2017.

to their fifth year of operation. This marks a major turnaround from the Great Recession, when business survival rates dropped to a low of 42.9 percent.¹⁰

While the recent uptick in entrepreneurship is indeed good news, it exists within the long-term decline I referenced.

Also concerning is the fact that new and young businesses today employ fewer workers on average than they used to. According to the Kauffman Main Street Entrepreneurship Index, small businesses have gotten even smaller over the last 20 years. The smallest of those small businesses—companies with one to four employees—make up 53.1 percent of all established small businesses.

Zero Barriers

As it becomes evident that the Entrepreneurship Deficit is one of America's biggest challenges, what can we do about it, and what can Congress do about it?

To start, we cannot afford to linger in the same debates and arguments of the past. The Entrepreneurship Deficit is causing hardships every day for people in your districts—fewer jobs, lower wages, and a lower quality of life.

As a response, the Kauffman Foundation today launched the Zero Barriers to Startup Challenge.

Our founder, Ewing Kauffman, believed that individuals have a fundamental right to take an idea they have and turn that into a business reality. To be an entrepreneur, you shouldn't need a formal degree. You shouldn't need expensive experts to navigate the process. It shouldn't matter your race, your gender, or where you live. You should be able to do it quickly, inexpensively, without confusion, and without barriers imposed by others.

Unfortunately, there is a big gap between that vision and today's reality.

The Zero Barriers to Startup Challenge is a collaborative, nationwide effort to identify barriers, big and small, that get in the way of new business creation. The Kauffman Foundation will team up with entrepreneurs, policymakers, and others nationwide to identify the key barriers to starting a business and then work together to identify and design solutions.

You can help people – current entrepreneurs and those with an idea afraid to make the leap – by engaging in this process. The Kauffman Foundation encourages members of Congress to host an “Entrepreneurs’ Town Hall” in your district, to tour entrepreneur support organizations, and to invite entrepreneurs to testify before this committee and others about the barriers they face.

¹⁰ Fairlie, Robert, Arnobio Morelix, Inara Tareque, Joshua Russell, and E.J. Reedy. “2016 Kauffman Index of Main Street Entrepreneurship.” Kauffman Foundation, November 2016.

After listening to entrepreneurs, we encourage you to act on the solutions, conversation by conversation, city by city, district by district.

We also support continued public investments in data collection. The Kauffman Foundation was able to identify the three megatrends because data was available from the U.S. Census Bureau, the Bureau of Labor Statistics, and other federal agencies.

Access to timely, quality data is so important to understanding how we can best help entrepreneurs that Kauffman invested in the creation of the Census Bureau's Annual Survey of Entrepreneurs. This and other public data collection efforts need to continue.

When barriers hinder Americans from pursuing their entrepreneurial dreams, our whole nation suffers. That's no longer conjecture; there is accumulating research evidence for it. Together, let's commit to lowering barriers to entrepreneurship so all Americans, regardless who they are or where they're from, can turn their ideas into reality.

Thank you, and I look forward to answering your questions.