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Small Business Research Summary
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Understanding Small Business Activity at the State Level

John Deskins, Creighton University; Tami Gurley-Calvez, West Virginia University; Eric Thompson, University of Nebraska–Lincoln. 36 pages. Under contract number SBAHQ-10-M-0267.

Purpose

The study examines the impact of small business activity by industry on overall state economic growth. A few studies have focused on the impact of small business in general at the state level, but their results make it clear that the differing industry mixes among states have skewed the results.

Overall Findings

Neighboring states would benefit more by acting like teams, rather than competitors. Small business activity is found to have positive spillover effects on neighboring states, not the siphoning effect that many may presume. But if states focus on particular industries, their state's performance will depend on how that industry does nationally and the results change over time so there is not one industry that they can focus on. Small business activity in various industries led to stronger gross state product (GSP) and employment growth during the 1988 to 1997 period but not the more recent 1998 to 2007 period. So a state's performance will depend on what industries do well for specific time periods and its industry mix.

Highlights

- While one might think that a greater amount of small business activity in neighboring states might detract from a state's own rate of economic growth, the study found the opposite. In the large majority of cases the results indicate that a neighboring state's small business activity has either a positive or statistically insignificant effect on economic growth.
- Optimal industries to target across growth measures change over time. Relationships that were found in earlier years deteriorated in later years. If developers try to pick and support industry winners they are creating a boom / bust environment or they can diversify their industry mix which could achieve more economic stability but be bereft of growth.
- During the 1988 to 1997 period, small business activity in three industries—manufacturing, transportation/communications/utilities, and finance/insurance/real estate industries—was associated with faster state economic growth. This did not hold for the 1998 to 2007 period. The results show that industries to target for economic developers are those that will do well in the future, not those that did well in the past.
- From 1998 through 2007, small business counts in the real estate and health care industries were associated with strong state economic growth, as were small business births in the transportation/communications/utilities and the finance and insurance industries. Small business activity in other industries was not associated with economic growth.
- Most of the positive economic growth effects of small business activity in the industries identified are larger than the effects of various state policy parameters. So having the right industry mix at the right time period is more important than making the correct policy decisions on such measures as taxation, or expenditures.
- When economic growth is measured in per capita terms, generally a smaller (in absolute terms) relationship between small business activity and state economic growth exists. This shows that the effect of

small business activity on state economic growth is not simply related to population (or labor) change.

Scope and Methodology

The study consists of panel regressions of state economic variables (GSP, employment, state personal income, GSP per capita and employment-population ratios) on measures of industry-specific small business activities and other controls. Annual state data for the contiguous United States for the periods 1988–1997 and 1998–2007 were analyzed. Independent variables were lagged by one year, expressing economic activity each year as a function of control variables (including small business measures) from the previous year's data. To capture interstate spillovers, states sharing a geopolitical border were identified and controlled for.

Model variables included an index of the price of energy in the state, the average wage for manufacturing workers in a state, a measure of the state's human capital stock (measured as the share of the state's population that has a bachelor's degree or higher), state unemployment rates, population density, the age distribution of a state's population, and several measures of state tax structures.

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