

Are American businesses thriving or in decline?

I am going to let you answer this question at the conclusion of this article. If we start with the premise that small to mid-sized businesses are the engine of economic growth, we need to count how many such businesses exist in the United States. There are 6 million businesses with one or more employees. The following table illustrates business distribution according to size.

Business Size ⁽¹⁾	Number of Businesses
1-4 employees	3.8 million
5-9 employees	1 million
10-19 employees	600,000
20-99 employees	500,000
100-499 employees	90,000
500-9999 employees	8,000
10,000 or more employees	1,000

With respect to overall employment, we will consider the bottom two rows (above 500 employees) as large business. If we exclude large business, the remaining firms employ roughly 48% of all Americans ⁽²⁾. That 48% are the small businesses that hope to either survive or become a large enterprise. How many will succeed?

There are a number of statistics suggesting business failure rates. I have read about 50% failure rates within the first year to 50% failure rates within 4 years. Whichever statistic you believe, for a small business to survive, let alone become a large business, is quite an undertaking with a low probability of occurrence.

Against this backdrop, let's examine American business birth and death rates. It's difficult for an economy to grow unless births continually outnumber deaths. If we concede that the business failure rate is high (death), hopefully we can count on business formation rates (birth) for balance in employment. In fact for the last 30 years business formation has steadily *declined*. The number firms shuttering hovered in the 8-9% range for many years until rising in 2004. Then something interesting occurred in 2008. Remember that year? Beginning in 2008, business deaths outnumbered births. The most recent statistic shows 70,000 more business deaths than births ⁽³⁾. Naturally, given this inversion in the birth/death process, a higher proportion of people (52%) work for large businesses ⁽⁴⁾. The last 30 years has witnessed a reduction of net new businesses and a greater concentration of people working for larger firms.

There are a number of reasons businesses fail and primary among them is capitalization. When Gallup asked small business owners about their initial source of funding, 77% cited personal savings. The persistent drop in the personal savings rate from the early 1970s until 2007 closely parallels the decline in business formation. The uptick in the savings rate from 2007 to 2012 (2.5% to 10.5%) was a result of the economic crisis and ensuing recession ⁽⁵⁾. At least within that 5-year timeframe, there was the recognition that savings formation was inadequate. Since

that high in 2012 savings rates have fallen back to the 5% range. I do not believe that even though savings rates are higher that it will correspond to greater business formation. The deflationary psychology I have discussed in [E\\$caping Oz](#) is becoming more entrenched. For their own financial well-being, individuals are saving more.

If you think the birth/death process is isolated to particular segments of the country, think again. A study ⁽⁶⁾ by the Brookings Institute showed how business formation was uniformly lower across the thirty years of data surveyed beginning in 1978. When researchers compared the period 1978-1980 to 2009-2011, the result was lower business formation, similar business dissolution rates, and much lower job reallocation rates. These trends were region agnostic. Another troubling trend emerged. In the early years of this study, the deviation in the birth/death statistics was broader than in the study's later years. This means that regions of the country (states or metro areas) are exhibiting similar behavior; one region is less likely to show different rates than another.

Business dynamism is certainly not as robust as noted by the rates of business formation and dissolution. What about dynamism with respect to currently operating firms? In my consulting [practice](#), I work with small to mid-sized businesses facing capitalization and debt problems.

On the capitalization side, businesses are challenged to obtain financing from commercial bank lenders. Underwriting standards are such that banks are more cautious about lending money to businesses without adequate cash flow. Given the earlier statistic about self-financing, this inability to obtain financing is confirmed. The niche lending market has expanded rapidly since 2008. This lending market consists of non-bank lenders, private equity, or venture capital financing. While this market's financing criteria in some cases may be more liberal, it is not without its attendant fees and higher interest rates. This is expected given the higher risks these lenders assume. While this source of credit is higher cost, at least it exists. My goal is to return such clients to commercial banking after their balance sheets and income statements become more appealing. Still, for many small business owners, there is an adjustment to having a financing relationship with an entity other than a commercial bank.

Small businesses facing debt problems are numerous. This is simply part of their existence. Since most small businesses have a large injection of personal savings, and savings rates are low, and commercial credit is not always available, it is easy to fathom how cash flow problems quickly develop into unpaid debts. Most of these debt problems progress through a predictable sequence. At its conclusion, the debt problem becomes a legal problem.

Contrary to popular belief, these debt problems do not resolve themselves in court. Some businesses choose to defend themselves in court despite an acknowledged debt – not a wise course of action. What has been most surprising is the overwhelming number of businesses who take no action when facing debt litigation. These businesses exhibit great indifference and automatically lose in court via a default judgment. Often these judgments have personal guaranty clauses, meaning both the business entity and individual are named. Judgments can

stay on the record for as many as ten years and can be renewed by the creditor if the judgment remains unsatisfied. The debt problem will not go away on its own. As Admiral Mike Mullen, former Chairman of the Joint Chiefs of Staff, once said to a Senate panel about threats to the security of the country, *"I believe our debt is the greatest threat to our national security."* While the Admiral was addressing our fiscal debt, impaired tax receipts from a contracting number of businesses does not help matters.

The indifference and apathy to resolve debt problems will simply accelerate that business becoming one of the death statistics noted earlier. If that business dies, the previous owner may be averse to starting another enterprise and even if they are favorably inclined, their ability to acquire credit will be compromised.

It's essential the American economy have innovation, but we need entrepreneurship as well. If new business formation lags and current business operators demonstrate a degree of indifference towards debts, the road ahead will be rife with potholes.

Business deaths are to be expected. Business ideas are not always sound, funding is often inadequate, and changing consumer habits are always in evidence. It may be as simple as someone who devised a better, cheaper way to provide a good or service. Regardless, we should welcome the small business leader who is ready to dust themselves off and start again. We need to encourage higher numbers of business formations and not just in certain areas of the country. There also needs to be an enhanced awareness of how to handle debt since current approaches for small to mid-sized business are ineffective.

Apple started in a garage with two people. Who will be the next Apple?

Is American business prospering or declining?

Sources:

- (1) Gallup Business Journal, January 2015
- (2) US Census Bureau, 2012 Statistics of U.S. Businesses
- (3) Gallup Business Journal, January 2015
- (4) US Census Bureau, 2012 Statistics of U.S. Businesses
- (5) Federal Reserve Bank of St. Louis
- (6) Economic Studies at Brookings: Declining Business Dynamism in the United States: A Look at States and Metros