Introduction

Chairwoman Velazquez and members of the Committee, thank you for inviting me to address this committee and for the opportunity to talk with you about "The Role of Small Businesses in Stimulating the Economy."

My name is Dennis Ceru, and I am an Adjunct Professor of Entrepreneurship at Babson College where I teach MBA courses in entrepreneurship and business strategy. I have over 25 years of experience delivering successful business and technology solutions through leadership and management positions in the high-tech, financial services, and healthcare fields.

The information that I will share with you today is derived in part from the research conducted by Babson College, The Global Entrepreneurship Monitor as well as my own perspectives from my work with entrepreneurship and small, growing and large companies.

Babson College

Located in Wellesley, Massachusetts; Babson College is recognized internationally for its entrepreneurial leadership in a changing global environment. Babson grants BS, MS and MBA degrees. Babson programs are accredited by the AACSB International—The Association to Advance Collegiate Schools of Business, and the New England Association of Schools and Colleges.

What is GEM?

Initiated in 1999 as a joint venture of Babson College and London Business School, the Global Entrepreneurship Monitor (GEM) project is the largest ongoing study of entrepreneurial dynamics in the world. Over the years national teams from over 60 countries and more than 65 universities world-wide have contributed to the project.

GEM is a major research project aimed at describing and analyzing entrepreneurial processes within a wide range of countries. In particular, GEM focuses on three main objectives:

- To measure differences in the level of entrepreneurial activity between countries
- To uncover factors determining the levels of entrepreneurial activity
- To identify policies that may enhance the level of entrepreneurial activity

GEM data provides information on the innovativeness, competitiveness and sector distributions of nascent entrepreneurs, thereby allowing scholars, business leaders and policy makers to study the characteristics of the entrepreneurial landscape of various countries.

Entrepreneurship is important *at both the individual and the national level. When entrepreneurs fail to develop their full economic potential, the broader economy suffers. A better understanding of the potential contribution of entrepreneurs to the business landscape will allow the design of more satisfactory programs and or regulation aimed at increasing the incidence and impact of entrepreneurship to the economy.*

UNITED STATES – 2007

MAIN CHARACTERISTICS OF ENTREPRENERIAL ACTIVITY

The level of early-stage entrepreneurial activity in the United States for the year 2007 is at 9.6%; a combination of nascent entrepreneurs (6.5%) and new business owners (3.4%). The overall level of new and established businesses is at 8.4%

There are gender differences in early-stage entrepreneurship in the United States with 62.2% of the early-stage entrepreneurs being male and 37.8% female. Of these, the majority identify an opportunity (80.3% of males & 84.8% of the females) rather than a necessity motive for their entrepreneurial activity.

Early-stage entrepreneurs in the United States believe their businesses have high potential with 22.0% expecting to create more than 10 jobs and over 50% growth in 5 years compared to only 7.1% of established business owners.

DEVELOPMENT OF ENTREPRENEURIAL ACTIVITY

Over 49.2% of early-stage companies plan to offer products that are new to some customers contrasting with only 31.2% of established business owners making this claim. More than 37.0% of early-stage ventures will use the very latest technology in their business as compared to 10.9% of established businesses.

By age group, more early-stage entrepreneurs in the United States are under 34 years old (41.6%) than established business owners where the most active group (33.1%) are over 45 years old. At least 61.8% of these early-stage entrepreneurs have at least some college education, with 51.7% having at least a college degree.

UNIQUE NATIONAL CHARACTERISTICS

Early-stage entrepreneurial activity in the United States is generally within the Consumer-oriented services sector (42.1%) with the Business-oriented services sector (34.8%) close behind followed by the Transforming sector (21.2%). There is little early-stage activity in the Extractive sector (3.7%).

Most of these early-stage companies (63.3%) expect at least some of their customers to be outside the United States, and 12.4% expect a quarter or more of their customers to be outside the country.

Experts in entrepreneurship overwhelmingly believe that there is sufficient equity funding (75.5%), debt funding (74.6%), and private funding (80.0%) for new and growing firms.

Government support for entrepreneurship is believed to be stronger at the local level (55%) than at the national level (45%).

CURRENT ISSUES

The slump in the housing market is causing distress in the banking and home building industries. Many small businesses and nascent entrepreneurs will be affected if the slump in the home building industry is prolonged; however the Federal Reserve is responding with a substantial cut in the interest rate.

Venture capital investments continue to grow with a 14% year-to-year increase in the annual amount invested portfolio companies in 2006 followed by an 11% increase in the first six months of 2007.

Proposed tax legislation currently under consideration by Congress would change the treatment of venture capitalists' profits from capital gains to ordinary income, affecting early-stage companies that represent the highest investment risk, but that also create the most jobs and opportunities for the American economy.

KEY INDICATORS

Nascent 6.5% Entrepreneurs
New Firm 3.4% Entrepreneurship
Established 5.0% Business Owners

Overall Percentage of Early-Stage Activity

Opportunity-based 83%
Necessity-based 16%
Male entrepreneurs 62%
Female 38% Entrepreneurs www.gemconsortium.org www.babson.edu

BACKGROUND

What is GEM?

Initiated in 1999 as a joint venture of Babson College and London Business School, the Global Entrepreneurship Monitor (GEM) project is the largest ongoing study of entrepreneurial dynamics in the world. Over the years national teams from over 60 countries and more than 65 universities world-wide have contributed to the project. A GEM planning meeting is held in January of each year where 200+ scholars from the various national teams collaborate with the coordination team in the collection of the data and the development of the project. The January 2008 meeting was held at Babson College.
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Is GEM relevant for policy?

Because of its scale and scope, as well as its academic rigor, GEM has already had significant policy impact in various countries and international organizations.

GEM data and analysis have been the catalyst for change (i.e., *Finland Entrepreneurship Project (2000),* and *Ireland Project on Women (2005)*)

GEM is accepted and well known as a Key Monitoring Instrument in well established policy arenas (i.e., *UK Competitiveness Council, Singapore and Spain Governments, Directory for European Enlargement, UN African Investment Advisory, Izdihar-Iraq USAID*)

GEM is routinely quoted in policy papers (i.e., *EU Green Paper and Action Plan, UK Treasury Competitiveness Report, Report by the Chancellor of the Exchequer*)

It takes a few years for a project of this size to stabilize. GEM is still very young. We expect its relevance to increase even further in the next few years. Now in its 10th year, the GEM project is recognized as one of the leading ongoing source of knowledge on entrepreneurial activity in the world.

Why is GEM important?

Important discoveries do not happen out of the blue in someone's head. Like in any scientific effort, important discoveries emerge as the result of long term research programs. GEM is the largest and most developed research program on entrepreneurship in the world. Entrepreneurship matters for growth and development. GEM is important because entrepreneurship is important and GEM has the potential to make us discover important things about entrepreneurship. www.gemconsortium.org www.babson.edu

GEM Data Collection: The Adult Population Survey

GEM takes a broad view of entrepreneurship and focuses on the role played by individuals in the entrepreneurial process. Unlike most entrepreneurship data sets that measure newer and smaller firms, GEM studies the behavior of *individuals* with respect to starting and managing a business. Furthermore, GEM views entrepreneurship as a process and considers people in entrepreneurial activity in different phases; from the very early phase when the business is in gestation to the established phase and possibly discontinuation of the business. A key GEM indicator is the prevalence rate of early-stage entrepreneurial activity (also known as the TEA index), represented by the shaded box in the figure below.

Potential entrepreneur: knowledge and skills Nascent entrepreneur: Involved in setting up a business Owner-manager of a young business (up to 3.5 years old)Owner-manager of an established business (more than 3.5 years old)**Total early-stage Entrepreneurial Activity (TEA) Conception Firm birth Persistence**

Within this context, GEM provides an umbrella under which a wide variety of entrepreneurial characteristics, such as motivations, innovativeness, competitiveness, and high-growth aspirations, can be systematically and rigorously studied.

In high-income countries, as per capita income increases and more opportunities for entrepreneurship may arise, the prevalence rate of early-stage entrepreneurship tends to increase. However, cultural, demographic, and institutional influences also shape the picture. For instance, many EU-countries tend to exhibit similar prevalence rates of early-stage entrepreneurial activity. Among high-income countries, Iceland (12.5%), Hong Kong (10.0%), and the United States (9.6%) show the highest levels of entrepreneurial activity. Lowest rates were found in Austria (2.4%), Puerto Rico (3.1%), and Belgium (3.2%).

The GEM results confirm that early-stage entrepreneurship is more likely to be opportunity-driven in high- income countries than in middle- and low-income countries, where entrepreneurship may in many cases be the only option for making a living. In high-income countries, wider job opportunities and social security provides more alternatives to entrepreneurship. This is also seen when evaluating entrepreneurship as a full-time or part-time occupation. For example, in Norway and Sweden, both countries with high per capita income and generous welfare systems, most early-stage entrepreneurial activity is part-time.

Both the GEM “red tape” index and the equivalent World Bank index correlate negatively with high-growth expectation entrepreneurial activity. All other things being equal, the more onerous a country’s new business regulations, and the more local experts perceive these regulations to be onerous, the lower the level of ambition among a country’s entrepreneurs. www.gemconsortium.org www.babson.edu

Defining Entrepreneurship

Entrepreneurship is a complex phenomenon that spans a variety of contexts. The varied definitions in entrepreneurship literature reflect this complexity. In line with its objectives, GEM takes a broad view of entrepreneurship and focuses on the role played by individuals in the entrepreneurial process. Unlike most entrepreneurship data sets that measure newer and smaller firms, GEM studies the behavior of individuals with respect to starting and managing a business. This differentiates GEM from other data sets, most of which record firm-level data on (new) firm registrations (see insert on next page). New firms are, most often, started by *individuals*, and individuals typically determine the entrepreneurial attitude of established businesses, regardless of size. Another important aspect is that, from the start of the project in 1999, GEM views entrepreneurship as a process and considers people in entrepreneurial activity in different phases, from the very early phase when business are in gestation to the established phase and possibly discontinuation of the business.

An individual entrepreneur who has succeeded in maintaining a business has gone through a process, and the characteristics of his or her actions, are a very useful way to study entrepreneurial behavior. The entrepreneurial process starts *before* the firm is operational. Someone who is just starting a venture and trying to make it in a very competitive market is an entrepreneur in spite of not having high-growth aspirations. On the other hand, a person may be an established business owner who has been in business for quite a number of years and still be innovative, competitive, and growth minded. This person is also an entrepreneur. GEM provides an umbrella under which a wide variety of entrepreneurial characteristics, such as motivations, innovativeness, competitiveness, and high-growth aspirations, can be systematically and rigorously studied.

Within this context, the GEM data collection covers the life cycle of the entrepreneurial process and looks at individuals at the point when they commit resources to start a business they expect to own themselves (nascent entrepreneurs); when they currently own and manage a new business that has paid salaries for more than three months but not more than 42 months (new business owners); and when they own and manage an established business that has been in operation for more than 42 months (established business owners). Figure 1 summarizes the entrepreneurial process and GEM's operational definitions.

Potential entrepreneur: knowledge and skills Nascent entrepreneur: Involved in setting up a business Owner-manager of a young business (up to 3.5 years old)Owner-manager of an established business (more than 3.5 years old)**Total early-stage Entrepreneurial Activity (TEA)**
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Figure 1 The Entrepreneurial Process and GEM Operational Definitions www.gemconsortium.org
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The Business Birthing Event

For GEM, the payment of any wages for more than three months to anybody, including the owners, is considered to be the "birth event" of actual businesses. Thus, the distinction between nascent entrepreneurs and new business owners depends on the age of the business. Businesses that have paid salaries and wages for more than three months and less than 42 months may be considered *new*. The cut-off point of 42 months has been made on a combination of theoretical and operational grounds[i]. The prevalence rate of nascent entrepreneurs and new business owners taken together may be viewed as an indicator of early-stage entrepreneurial activity in a country. It represents dynamic new firm activity; even if a fair share of nascent entrepreneurs do not succeed in getting the business started, their actions may have an effect on the economy since they can put pressure on incumbent firms to perform better.

Business owners who have paid salaries and wages for more than 42 months are classified as "established business owners." Their businesses have survived the liability of newness. High rates of established business ownership may indeed indicate positive conditions for firm survival. However, this is not necessarily the case. If a country exhibits high degree of established entrepreneurship combined with low degree of early-stage entrepreneurial activity, this indicates a low level of dynamism in entrepreneurial activity.

In 2007 over 150,000 adults were interviewed between May and October (outside holiday seasons) with questions on their attitudes to and involvement in entrepreneurial activity in the 42 GEM nations.

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Glossary of Main Measures and Terminology

Measure	Description
Entrepreneurial Activity Prevalence Rates in Adult Population	
Nascent Entrepreneurship Rate	Percentage of 18-64 population who are currently a nascent entrepreneur, i.e. actively involved in setting up a business they will own or co-own; this business has not paid salaries, wages or any other payments to the owners for more than 3 months
New Business Ownership Rate	Percentage of 18-64 population who are currently a owner-manager of a new business, i.e., owning and managing a running business that has paid salaries, wages or any other payments to the owners for more than three months, but not more than 42 months
Early-Stage Entrepreneurial Activity (TEA)	Percentage of 18-64 population who are either a nascent entrepreneur or owner-manager of a new business (as defined above)
Established Business Ownership Rate	Percentage of 18-64 population who are currently owner-manager of an established business, i.e. owning and managing a running business that has paid salaries, wages or any other payments to the owners for more than 42 months
Overall Entrepreneurial Activity Rate	Percentage of 18-64 population who are either involved in early-stage entrepreneurial activity or owner-manager of an established business (as defined above)
High Growth Expectation Early-Stage Entrepreneurial Activity (HEA)	Percentage of 18-64 population who are either a nascent entrepreneur or owner-manager of a new business (as defined above) *and* expect to employ at least 20 employees five years from now
Business Discontinuation Rate	Percentage of 18-64 population who have, in the past 12 months, discontinued a business, either by selling, shutting down or otherwise discontinuing an owner/management relationship with the business. Note: this is NOT a measure of business failure rates.
Characteristics of Early-Stage Entrepreneurial Activity	
Improvement-Driven Opportunity Entrepreneurial Activity: Relative Prevalence	Percentage of those involved in early-stage entrepreneurial activity (as defined above) who (i) claim to be driven by opportunity as opposed to finding no other option for work; and (ii) who indicate the main driver for being involved in this opportunity is being independent or increasing their income, rather than just maintaining their income
High Growth Expectation Early-Stage Entrepreneurial Activity: Relative Prevalence	Percentage of early-stage entrepreneurs (as defined above) who expect to employ at least 20 employees five years from now
New Product-Market Oriented Early-Stage Entrepreneurial Activity: Relative Prevalence	Percentage of early-stage entrepreneurs (as defined above) who indicate that their product or service is new to at least some customers and indicate that not many businesses offer the same product or service
International-Oriented Early-Stage Entrepreneurial Activity: Relative Prevalence	Percentage of early-stage entrepreneurs (as defined above) who indicate that at least 25% of their customers are from foreign countries
Entrepreneurial Perceptions	
Perceived Opportunities	Percentage of 18-64 population (individuals involved in any stage of entrepreneurial activity excluded)