



John Colla, Associate

## The Unsung Heroes of the U.S. Economy

BY JOHN COLLA, ASSOCIATE, ICG

*"Small Businesses are really the engine in the economy"*

- Karen Mills, Former Administrator of the U.S. Small Business Administration

When I was young, my Father owned and operated a small grocery store in Northeast Ohio. I admired him and strived to own a store one day. What kid wouldn't love playing hide-and-seek in Dad's store and grabbing ice cream on the way out?

As I got older I valued my father's work ethic, motivation, and his ability to support our family. As I came to realize, my experience was not unique as there were countless other small businesses in our town and all across the country.

Not only are small businesses important to families, they play a significant role in the health of the U.S. economy. These "unsung heroes" are one of the main drivers of our economic growth.

### The Importance of Small Business to the United States

What is considered a small business? A small business is defined by the U.S. Small Business Administration (SBA) as a for-profit business that is located and primarily operates within the United States. To assess small business status, the SBA has established size standards: a maximum of 500 employees for most manufacturing and mining industries or no greater than \$7.5 million in average annual revenue for most

## Hartland Continues to Bolster Team with New Talent

We are pleased to announce that Monica Williams has joined Hartland as Administrative Assistant in our Institutional Client Group.

Prior to joining Hartland, Monica was a student at Cleveland State University, where she completed a MA in English, and served as a Graduate Assistant and Writing Tutor. Monica also holds a BA in English from Lake Erie College. Monica's volunteer efforts are focused on public charter schools and online learning.

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nonmanufacturing industries. There are a number of exceptions that vary upon business classification, which the SBA uses the North American Industry Classification System (NAICS). NAICS breaks down small business industries and sectors into over a thousand different classifications.<sup>1</sup>

Small businesses are key to the United States due to their contributions to employment and labor markets and product innovation, but most importantly, to economic growth. In 2013, there were 28.8 million small businesses which represented 99.7% of all employer firms in the United States.<sup>2</sup> That number continues to grow, and the importance to the jobs market is substantial. In a study done by the U.S. Bureau of Labor Statistics, small businesses accounted for 63.3% of net new jobs from 3Q 1992 until 3Q 2013. The portion of net job change attributable to small businesses was strongly positive over this timeframe, with the exception of two recessionary periods (2001-2002, 2007-2009).<sup>3</sup>

As we have seen over the past 20 years, innovation and technology has altered the way we go about our daily lives and transformed the world we live in today. Small businesses, even though with less capital and funding than larger firms, are essential in providing innovative ideas. According to the SBA, small businesses develop more patents per worker than larger firms.<sup>1</sup> Small businesses are positioned closer to the customer, giving them the ability to adapt quickly to changing consumer demands and continuously challenge product improvement.

Economic growth is heavily reliant on small businesses. It is estimated that small businesses generate approximately 50% of the economic growth of the U.S. gross domestic product (GDP).<sup>1</sup> In an appearance on Bloomberg TV this past November, Maria Contreras-Sweet (Administrator for the SBA from 2014-2017) discussed how small businesses were the driving force of the U.S. economy. She stated: “the SBA is now at record lending, record investments and record contracting”.<sup>4</sup> All of these factors, along with small businesses contributions to jobs and innovation, play an important role in the overall growth of our economy.

## Small Business Optimism Index

With the dependence of the U.S. economy on small businesses, there are several indexes that track the health of this segment. One survey, the Small Business Optimism Index, has proven over time to be a reliable gauge of small business economic activity. The Small Business Optimism Index is calculated using data from The National Federation of Independent Business (NFIB), which represents over 325,000 small businesses from every industry and sector across all 50 states. The NFIB collects data through random samples of its members using a monthly assessment called Small Business Economic Trends (SBET). SBET assesses the U.S. small business market and its near-term prospects. The Optimism Index is a composite of ten SBET indicators that provide a monthly reading of the state of the small businesses.<sup>5</sup> Many of the Index indicators are considered to be forward-looking, therefore indicative of what is to come for small businesses in the near-term. The ten indicators are listed below:

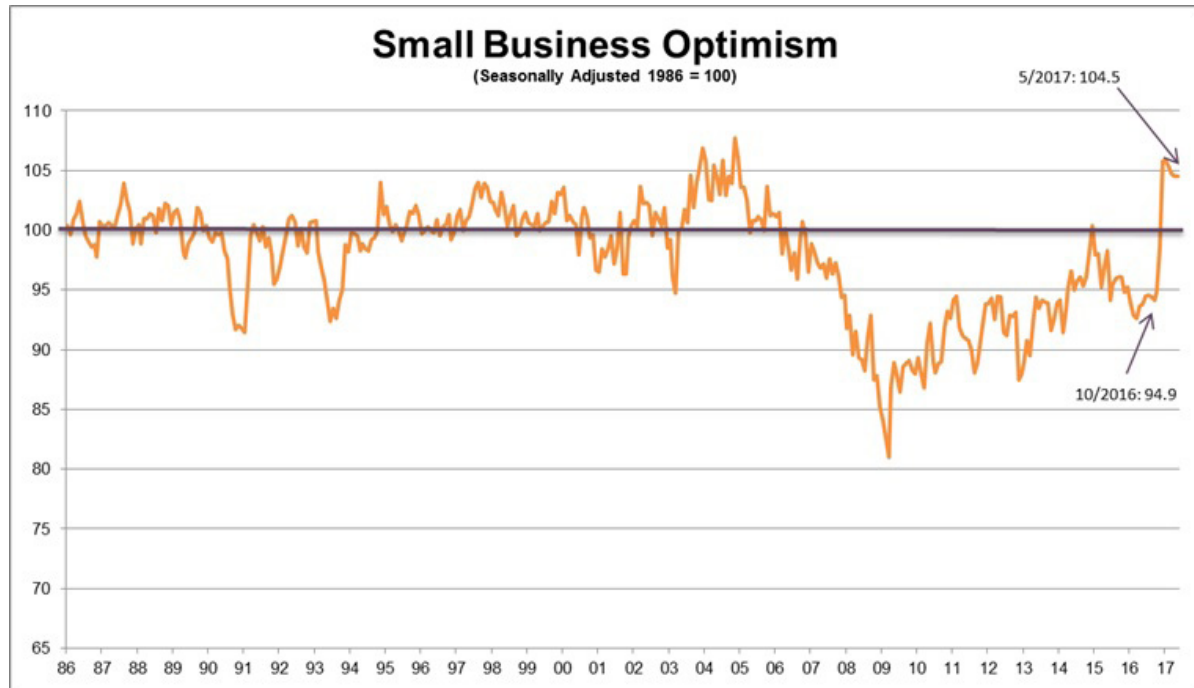
Small Business Optimism Index Indicators
Good Time for Expansion
General Economic Outlook
Expected Sales
Current Earnings
Planned Capital Outlays
Current Job Openings
Hiring Plans
Inventory Status
Expected Inventory Change
Expected Credit Conditions

Source: National Federation of Independent Business

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Since last November, Small Business Optimism has risen near record highs. As shown in the chart below, the Index rose above 105 in December (2016) for the second time since its inception in 1986. The Index currently sits at 104.5.<sup>4</sup>



In the most recent (May) monthly score, five Index components rose, four declined, and one remained unchanged. Indicators related to labor markets continue to show strength, and capital spending remained high while sales trends continued to increase. These indicators, plus an improved economic outlook, all added to Small Business Optimism in May. One major detractor to the Index was indicators related to inventory, as more firms saw buildups of inventory and less of a need to add to existing levels.<sup>6</sup> Although inventory has been a headwind for Small Business Optimism, strong demand and increasing sales could reverse this trend.

## Tax Reform and Deregulation

It is no surprise that Small Business Optimism received a big boost in November. Small businesses are enthusiastic about potential tax reform and deregulation from the new administration. Due to their structure, small businesses often are taxed at higher rates. Cutting taxes for small businesses can make them become more competitive with larger firms.

Regulation and compliance pose significant challenges to small businesses. Deregulation could be beneficial to small businesses allowing them to focus more of their efforts on business-related tasks and growth as opposed to compliance issues. For example, the cost of tax compliance is approximately 67% higher for small businesses than larger firms.<sup>1</sup> Less regulation could also promote the startup of more small businesses.

Both tax reform and deregulation can relieve some of the excess burden small businesses face and change how they currently operate.

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Small businesses are a significant driver of the U.S. economy and their ability to succeed is important. Confidence among small businesses has remained high over the past several months and provides hope of more robust economic growth moving forward. Tax reform and deregulation is the remedy to jumpstart small businesses, which in turn will drive U.S. economic growth.

Just as when I was younger, I continue to have a great appreciation for small businesses and their contributions to this country. Every now and then I go back to my hometown and visit my Father's store. I may not be running down the aisles or playing hide-and-seek anymore, but I'll still grab ice cream on the way out.

<sup>1</sup>U.S. Small Business Administration, Office of Advocacy

<sup>2</sup>U.S. Census Bureau, Statistics of U.S. Businesses

<sup>3</sup>U.S. Bureau of Labor Statistics, Business Employment Dynamics

<sup>4</sup>Bloomberg

<sup>5</sup>National Federation of Independent Business

<sup>6</sup>National Federation of Independent Business, Small Business Economic Trends

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The performance data shown represent past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.

## MARKET BENCHMARK RETURNS

June 30, 2017		1M	3M	12M	YTD
US Large Cap	S&P 500	0.6%	3.1%	17.9%	9.3%
US Small Cap	Russell 2000	3.5%	2.5%	24.6%	5.0%
Developed Intl	MSCI EAFE	-0.1%	6.4%	20.8%	14.2%
Emerging Intl	MSCI Em Mkt	1.1%	6.4%	24.2%	18.6%
Real Estate	NAREIT	2.0%	2.4%	1.4%	5.4%
Core Fixed	BarCap Agg	-0.1%	1.4%	-0.3%	2.3%
Short Fixed	BarCap 1-3Yr	0.0%	0.3%	0.3%	0.7%
Long Fixed	BarCap 10+Yr	0.8%	4.4%	-1.1%	6.0%
Corp Debt	BarCap Corp	0.3%	2.4%	1.8%	3.7%

Source: Bloomberg

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