Everyone Wants to Start a Business

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Last year a record number of Americans started companies. Here's why becoming your own boss has become a national obsession.

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NEW YORK -- Once upon a time, small business was seen solely as the domain of idiosyncratic, iconoclastic outsiders, willing to forgo the security of corporate life to venture out on their own. But today entrepreneurs are America's role models.

Almost everyone wants to own a business - from college students, who are signing up for entrepreneurial courses in record numbers; to those over age 65, who are forming more companies every year; to recent immigrants, who in 2005 started 25 percent more companies per capita than native-born citizens did.

We are in the midst of the largest entrepreneurial surge this country has ever seen. According to Small Business Administration projections, nearly 672,000 new companies with employees were created in 2005. That is the biggest business birthrate in U.S. history: 30,000 more startups than in 2004, and 12 percent more than at the height of dot-com hysteria in 1996.

And the trend shows no sign of abating. The Bureau of Labor Statistics found that more businesses were created in the first quarter of 2006 than during the same period the previous year. Not only are more Americans launching small businesses, but most others are dreaming about it: Sixty-six percent of respondents in a 2006 Yahoo Small Business and Harris Interactive survey said they wanted to start a company someday; 37 percent of those said they hoped to do so within the next five years.

This trend is of course flattering to established entrepreneurs: They were small before it was beautiful. But what does it mean in dollars and cents? A world full of new competitors - and new opportunities. All these nascent businesses require services, technology, and expertise - demands that have launched an echo boom of small businesses seeking to serve other small businesses.

"It's such a huge market," says Gourab Nanda, 34, who started MyBusinessAssistant.com last year to provide virtual business-management solutions to small companies. "All you have to do is identify your customers, provide the services, and keep prices low."

Potential customers among new business owners can be found almost anywhere. That's because the current entrepreneurial boom is not only larger than that of the mid-1990s, but also more diverse. Everyone is partaking of this surge - women, minorities, immigrants, teenagers, and corporate refugees alike.

But the diversity is more than demographic; it extends to the companies themselves. The last startup expansion was fueled mostly by technology firms. While plenty of those are still being launched, the number of new service companies - which include tech firms - fell by nearly 14 percent from 1996 to 2005, according to the Kauffman Foundation (kauffman.org), which tracks and promotes entrepreneurship. Meanwhile, some old-school sectors are enjoying rapid growth. Since 1996 the number of construction startups has jumped 7 percent, and manufacturing has grown by a remarkable 43 percent.

Entrepreneurs don't just constitute a larger portion of our workforce; they also contribute a larger share of tax revenue. The owners and partners of privately held companies pay more than 54 percent of all individual income taxes, according to the Tax Foundation (taxfoundation.org), a nonprofit research institution. And on personal tax returns, more than 37 percent of individuals in the highest tax bracket are business owners. (That figure includes owners of large private companies, as well as wealthy individuals who happen to invest in small business. But, according to Scott Hodge, president of the Tax Foundation, entrepreneurs make up most of that 37 percent.) Meanwhile, the majority of business tax returns are now filed by small businesses; the Tax Foundation estimates that 60 percent of all corporate tax returns are now from S-corporations. From 1980 to 2005, the number of S-corporations, farms, sole proprietorships, and partnerships filing business returns grew by 572 percent, to 3.7 million.

Small businesses have long been referred to as the engine of the national economy. Today they're also providing the fuel. Forrester Research (forrester.com), a technology research firm in Cambridge, Mass., found that in 2006 U.S. small businesses spent about $138 billion on technology products and services, accounting for 19 percent of all IT spending. And according to a 2005 study by Gartner, a technology consulting group in Stamford, Conn., companies that employed 20 to 99 expected to increase their IT budgets by 7 percent in 2006 - a figure that fell to just 2 percent among companies that employed 500 to 999.

Entrepreneurship remains a risky endeavor. The SBA projects that 544,800 small businesses closed in 2005, a slight increase from the 540,658 that closed in 2003. An additional 39,201 probably filed for bankruptcy, according to SBA estimates, up from 35,037 in 2003.

And yet it's arguably less risky to create a business now than ever before. A half-decade of rock-bottom interest rates has made it easier and cheaper for new entrepreneurs to borrow startup funds. Meanwhile, venture capital funds and other private equity investors are once again pouring money into young companies. "We are figuring out new ways to bring increasingly huge amounts of capital to startups," says Carl Schramm, head of the Kauffman Foundation and author of The Entrepreneurial Imperative. Schramm also points out that even as startup money is becoming more readily available, plummeting technology costs make it less necessary now that entrepreneurs often can purchase powerful computers and software without maxing out their credit cards.

At the same time, the perks that corporate America once promised have lost most of their allure. Job security? Between 70,000 and 80,000 corporate employees are laid off every month, about 30,000 more than just six years ago, according to James Pedderson, director of public relations at Challenger Gray & Christmas (challengergray.com), which tracks national layoff statistics.

Pedderson also points out that top executive positions are less secure than ever; 1,322 CEOs left their jobs in 2005, twice as many as in the previous year. Pension funds and health-care benefits, once guarantees of employee loyalty, are being trimmed or abolished. Even stock options - the Holy Grail of the mid-1990s IPO craze - are offered less frequently. If the risks of starting a business are lower and the rewards of staying at a corporate job have also fallen, then it's no wonder that more Americans are turning to entrepreneurship.

Robert Fairlie, an economist at the University of California at Santa Cruz, says that the recent fluctuations of the labor market may have provided another spark. Many recently downsized tech professionals, facing a tough job environment, have turned to entrepreneurship, he says. But even though the trend is back toward low unemployment, that isn't depressing startup rates. Fairlie points out that today's strong labor economy may make risk-taking easier, because an entrepreneur can more easily find a job if her venture fails.

Meanwhile, it has become easier for entrepreneurs to start new companies without quitting their day jobs. According to the SBA, the total number of firms with no employees grew by 26% from 1997 to 2004, to 19 million. A little more than half of those companies are run by workers with another primary source of income.

If the nation's love affair with entrepreneurship continues, then we are in for a bright future. Despite their competitive reputations, entrepreneurs are more likely to get involved in their communities, through service on elected and appointed boards and other types of volunteer work. And they lead the nation in charitable donations. According to a study from Bank of America and Indiana University comparing wealthy individuals from various backgrounds, those whose money came from entrepreneurial activity donated an average of $232,206 in 2005. That's more than twice the amount given by the next highest group, those with inherited wealth. They averaged only $109,745. And those whose wealth came from real estate tailed the group, at $11,015.

"If I inherit a lot of money, I may feel a fiduciary obligation to preserve the corpus," says Patrick Rooney, director of research at the Center on Philanthropy at Indiana University. "But a person who creates wealth, a risk-taker, says 'If I lose it all, I can go out and create it again.' "

A country with more small businesses is, by and large, a more innovative country. In 2002, according to Chicago-based consulting firm the Patent Board (patentboard.com), entrepreneurs accounted for 40% of "highly innovative" firms - those with 15 or more patents in the previous five years. Even as companies such as Sun Microsystems have trimmed their R&D budgets, others have been snapping up inventive smaller firms and outsourcing their research efforts.

Typically, acquisitions for less than $50 million indicate that a smaller company has been purchased by a larger one seeking access to an innovative product or process. In 1995 there were 322 such acquisitions; in 2004 there were more than 1,400, according to FactSet Mergerstat (mergerstat.com), a mergers and acquisition data firm based in Santa Monica.

Indeed, innovative entrepreneurs may help keep the country afloat in a time of global uncertainty. Even as emerging overseas economies, including India's and China's, become more competitive, no other country can rival America's appetite for entrepreneurial experimentation.

"That's a great thing about America, that our culture accepts this risk and accepts people who try new things," legendary computer entrepreneur Michael Dell, chairman of Dell, said in a recent interview with FSB. "Many nations have capital, many nations have smart people, but no nation really compares to the U.S. in terms of its willingness to accept risk takers in society."