Small Business

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KEY POINTS

- Over the last five years, the six-county area studied has experienced a 25% increase in the number of small and medium-sized enterprises (known as SMEs).
- SMEs employ about 80% of the workforce in the six counties, similar to statewide employment by SMEs of 79%.
- Smaller SMEs (with 4 or fewer employees) are most prevalent and account for 66% of all SMEs.
- A recent study by LendingTree[1] identified Fresno as the second-best location in California for small businesses to succeed.
- Certified Development Financial Institutions (CDFIs) are a viable source of start-up capital for new ventures as well as operating loans and lines of credit for established SMEs. The Valley Small Business Development Corporation in Fresno is certified as a CDFI.

The U.S. Small Business Administration (SBA) defines a small business as a firm employing fewer than 500 employees[2] and refers to such firms as small and medium-sized enterprises (SMEs). The role small businesses play in the Central Valley is significant. This article discusses the state of SMEs in the six-county area of Fresno, Kern, Kings, Madera, Merced, and Tulare. This article also describes the role CDFIs play in the consistently challenging aspect of obtaining financing for SMEs.

Smaller SMEs (four or fewer employees) ACCOUNT FOR 66% OF ALL OF SMEs.

Table 1
Number of SMEs in the Six-County Area and California

Year	Number of Small Businesses	Percentage Change from Previous Year	Number of Small Businesses	Percentage Change from Previous Year
2012	63,309	(12%)	1,313,104	(5%)
2013	68,622	8%	1,338,658	2%
2014	70,130	2%	1,372,227	3%
2015	72,846	4%	1,421,565	4%
2016	75,783	4%	1,479,121	4%
2017	79,275	5%	1,524,414	3%
Net Increase for the 5-Year Period	15,966	25%	211,310	16%

Data Source: California Employment Development Department

Table 2
Number of Individuals Employed by SMEs in the Six-County Area

Year	Number of Workers Employed by Small Businesses	Percentage Change from Previous Year
2012	760,346	2%
2013	773,106	2%
2014	798,800	3%
2015	812,162	2%
2016	765,969	(6%)
2017	837,950	9%
Net Increase for the 5-Year Period	77,604	10%

Data Source: California Employment Development Department

Table 3
SMEs by Number of Employees by County for 2017

Counties	Total SMEs	≤ 4	5-9	10-19	20-49	50-99	100-249	250-499
Fresno	35,325	25,272	3,603	2,787	2,363	800	389	111
Kern	18,816	11,126	2,585	2,234	1,747	668	358	98
Kings	3,918	2,674	459	354	267	92	58	14
Madera	4,247	2,947	480	342	304	106	56	12
Merced	6,633	4,499	797	621	460	151	84	21
Tulare	10,336	6,160	1,505	1,173	973	299	174	52
Total	**79,275**	**52,678**	**9,429**	**7,511**	**6,114**	**2,116**	**1,119**	**308**

Data Source: California Employment Development Department

The six-county area ADDED A NET OF 16,000 ENTERPRISES from 2012 to 2017, while the STATE ADDED OVER 200,000.

Table 1 compares growth in small businesses from 2012 through 2017 for the six-county area and for California. According to data from the California Employment Development Department,[3] the six-county area added a net of 16,000 enterprises from 2012 to 2017, while the state added over 200,000. The one-year increase from 2016 to 2017 in the six-county area (5%) was slightly higher than the one-year increase statewide (3%). However, the six-county area experienced a 25% increase in SMEs over the five-year period while growth for the State of California was lower at 16%.

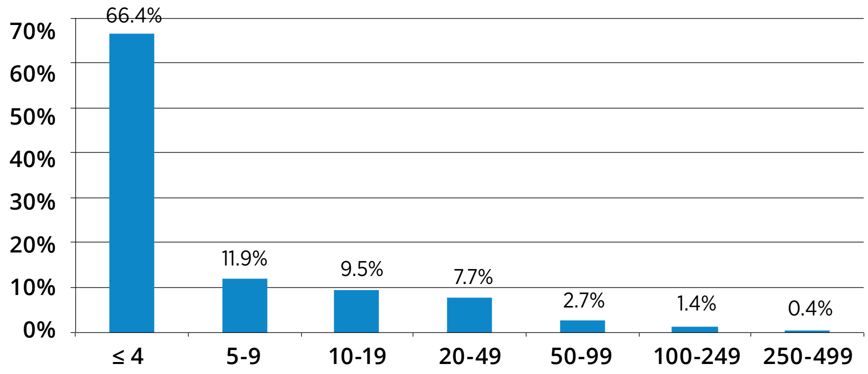
Small Business Employment

As seen in Table 2, SMEs in the Central Valley employed 837,950 people in 2017, an addition of over 77,000 jobs since 2012. Total employment in SMEs represents 80% of all employees in the workforce for the six counties and is similar to the state's at 79%.

The EDD classifies SMEs based on number of employees using data from unemployment insurance contribution filings. Table 3 and Figure 1 categorize small businesses in this manner for the six counties for 2017. The smaller SMEs (≤ 4 employees) are most prevalent, with 66% of the total. Overall, SMEs employing 50 or more individuals represent less than 5% of all SMEs in the six-county area.

Small Business

Figure 1
Percent of SME's by Number of Employees for 2017



Data Source: California Employment Development Department

Table 4
Percentage of Employment by Sector for SMEs for 2017

Industry	Fresno	Kern	Kings	Madera	Merced	Tulare
Services	71.7%	60.3%	67.8%	63.5%	63.5%	54.9%
Ag, Forestry, Fishing, Hunting	4.6%	4.5%	9.8%	10.9%	12.1%	12.4%
Retail Trade	7.1%	10.9%	7.4%	7.4%	8.5%	10.6%
Construction and Mining	4.6%	7.8%	3.4%	5.7%	4.6%	6.1%
Other	12.0%	16.5%	11.6%	12.5%	11.3%	16.0%

Data Source: California Employment Development Department

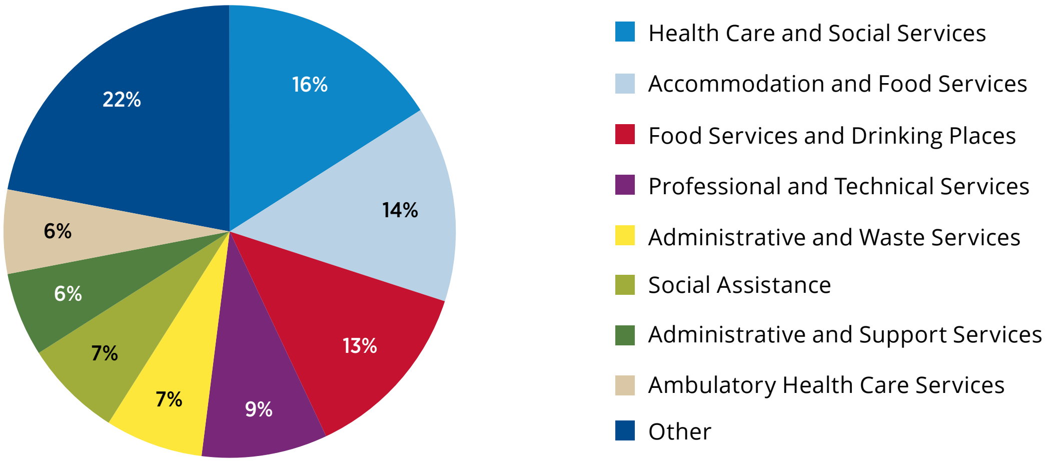
As Table 4 shows, the services sector represents well over half of employment in SMEs in all six counties. The top four sectors shown in Table 4 account for over 80% of all SME employment.

Services are classified statewide by the California Employment Development Department. The percent share of employment in each of the classifications is presented in Figure 2, which identifies the top three services as health care and social services, accommodation and food services, and food services and drinking places. Together these three categories account for about 43% of services.

The Small Business Environment

A recent study by LendingTree[4] identified Fresno as the second-best location in California for small businesses to succeed. The LendingTree study used data from more than 80,000 loan requests

Figure 2
Share of employment in the Services Sector by Category for California for 2017



Data Source: California Employment Development Department submitted by small business owners seeking loan offers through LendingTree's small business loan marketplace between January 1, 2016 and January 23, 2018. The study used annual revenue and profitability of these small businesses to determine how well they were doing relative to their peers in other locations. The analysis included firms with annual revenues less than $7,500,000, and firms that had been in business for at least six months but not longer than 60 months. The self-reported data was then limited to the 50 most populous metropolitan statistical areas, as defined by the U.S. Census Bureau.

Through this research, LendingTree was able to identify how small start-ups are performing relative to their peers in other places. The results show that three California cities – Sacramento, Los Angeles and Fresno – ranked among the top 10 best places for small business in the nation. The findings from the LendingTree study indicate small business start-ups thrive best in Sacramento, where the average annual revenue of SMEs was $315,661, and 84.3 percent of small businesses applicants were profitable. For Fresno, businesses averaged $292,599 in annual revenue and 81.5 percent of applicants reported that their small business was profitable.

Small Business Financing

A healthy small business environment, such as those described in the LendingTree study, provides small businesses with access to credit resources. Small business are generally unable to

A recent study by LendingTree identifed Fresno as the second-best location in California for small businesses to succeed.

access public institutional debt or equity capital markets; thus, bank loans have historically been an important source of credit. The recession and credit crisis of 2008-2011 significantly impacted small businesses' ability to access credit through traditional banks.[5] According to Mills and McCarthy, during the financial crisis, small businesses were less able to secure bank credit because of a "perfect storm" of falling sales, weakened collateral and risk aversion among lenders.

This more restrictive lending environment has continued. According to the National Small Business Association's 2015 Year-End Economic Report, lack of access to capital and cash flow difficulties play a large role in small business failures. The report indicates that 27% of small business owners reported not being able to access enough capital to operate their business in 2015.[6]

While the recession and post-recession restricted traditional types of credit, the period also allowed for the growth of an alternative credit resource – the Certified Development Financial Institution (CDFI). Since the recession, CDFIs have become a viable source of start-up capital as well as operating loans and lines of credit for established SMEs. While funding a small business can be challenging, small business owners and start-ups have access to additional financing options through CDFIs.

Certified Development Financial Institutions

CDFIs are approved, either federally or by a state, to operate in the community-banking arena as niche lenders. CDFIs were established by the Riegle Community Development and Regulatory Improvement Act of 1994, and many have a mission-based lending model targeting a specific population and/or specific loan type such as SBA microloans or Rural Micro-Entrepreneur Assistance Program loans. Some CDFIs have access to the Bank Enterprise Award Program, which provides FDIC-insured depository institutions awards for investing in CDFIs or in their own bank lending, investing, or service-related activities in distressed communities.

Other CDFIs are the delivery mechanism for government guaranteed loans, such as the SBA Community Advantage Program. The common theme is that CDFIs have the ability to meet the needs of underserved SMEs and supply funding to small businesses, which in turn stimulates the growth of the local economy.

Small Business

In the Central Valley, the Valley Small Business Development Corporation (VSBDC) is certified as a CDFI. VSBDC was created in 1981 as a non-profit, for public benefit corporation to act as an intermediary Financial Development Corporation on behalf of the State of California to administer the State Loan Guarantee Program. Among other activities, VSBDC makes direct loans in a nine-county area in the San Joaquin Valley and provides loan guarantees to bank lenders statewide.

In 2011, the loan guarantee program was expanded with funding under the Federal Small Jobs Initiative and enabled VSBDC and other CDFIs to provide up to 80% loan guarantees for up to $2.5 million to commercial banks making loans to small businesses. With a guarantee of 80%, the traditional bank lender assumes only a 20% risk on the loan. While the borrower's operation must project the ability to repay the loan request, there are no minimum liquidity requirements and/or collateral ratios to be met. This program is available to commercial lenders and credit unions in the Central Valley. Prospective small business borrowers can often find financing with VSBDC directly, depending upon the size of the loan request and the availability of funding. As a CDFI, VSBDC is uniquely suited to fund start-up businesses and entrepreneurs may initiate their requests directly with VSBDC.

A loan from VSBDC (or any other CDFI) will carry a slightly higher interest rate than those charged by commercial banks. However, an advantage for borrowers is that they can also receive technical assistance to guide them through the start-up process – either from the CDFI directly or from their network of technical assistance providers such as SCORE or the Small Business Development Centers.

VSBDC and other CDFIs cannot exist unless they make prudent decisions about the repayment capabilities of their borrowers. They also cannot be profitable if they do not make solid loans that generate earnings and attract other funders that will earmark lendable funding dollars for the CDFIs to distribute. Even though VSBCD funds loans with greater risk levels than commercial banks, the overall default rate on their direct loans is 3.18% and on loan guarantees is less than .01%. During the economic recession in 2009-11, the overall loss rate on the loan guarantee program locally was .0288%. Considering that these loans include some that may have been denied by conventional lenders, that loss rate is admirable by any lending standard.

CDFIs CAN PROVIDE LOAN GUARANTEES OF UP TO 80% for commercial banks making loans to small businesses.

In summary, the healthy small business environment in the area is enhanced not only by conventional sources of financing, but non-conventional sources like CDFIs. The small business borrower or entrepreneur who has been denied credit by a commercial bank has other options available and may consider financing with a CDFI lender, such as the Valley Small Business Development Corporation. Access to multiple sources of financing appears to be a key element in the area's growth and small business success.

Endnotes

1 LendingTree study (https://www.lendingtree.com/business/small/lendingtree-ranks-best-worst-cities-new-small-businesses/)

2 U.S. Small Business Administration (https://www.sba.gov/)

3 The Employment Development Department (EDD) – State of California (https://www.labormarketinfo.edd.ca.gov/LMID/Size_of_Business_Data.html)

4 LendingTree study (https://www.lendingtree.com/business/small/lendingtree-ranks-best-worst-cities-new-small-businesses/)

5 Karen Gordon Mills and Brayden McCarthy *The State of Small Business Lending: Credit Access During the Recovery and How Technology May Change the Game* Working Paper 15-004, Harvard Business School, July 2014

6 Small Business Administration. Retrieved from https://www.sba.gov/sites/default/files/advocacy/Frequently-Asked-Questions-Small-Business-2018.pdf