

The Hidden Engine: Unraveling the Impact of Small Businesses on any National GDP

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ABSTRACT

Small businesses are often overlooked in discussions of economic growth, yet they play a vital role in driving the engine of a nation's GDP. This paper seeks to illuminate the significant impact of small businesses on national GDP, shedding light on their often-underestimated contributions. Through a comprehensive analysis of economic data and case studies, this paper reveals how small businesses serve as the hidden engine propelling economic growth. From job creation to innovation, small businesses serve as the lifeblood of many economies, fueling productivity and prosperity. By unraveling the intricate connections between small businesses and national GDP, this paper underscores the essential role these enterprises play in shaping the economic landscape of any nation.

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Introduction

Small businesses serve as the backbone of economies worldwide, contributing significantly to economic growth, job creation, and innovation. In the United States alone, small businesses account for over 99% of all businesses and employ nearly half of the private-sector workforce [1]. These enterprises play a crucial role in fostering entrepreneurship, driving local development, and enhancing competitiveness. Despite their size, small businesses wield substantial economic influence and are essential drivers of prosperity.

The purpose of this report is to delve into the often-underestimated impact of small businesses on national GDP. By unraveling the intricate connections between small businesses and economic growth, this study aims to shed light on their vital role in shaping the economic landscape. Specifically, this report seeks to analyze the mechanisms through which small businesses contribute to national GDP, explore the factors influencing their contribution, and provide insights into policy implications for fostering small business growth.

The structure of the paper is organized as follows: First, the significance of small businesses in the economy will be discussed, highlighting their role as engines of growth and innovation. Next, the report will present a theoretical framework elucidating the relationship between small businesses and national GDP. Following this, empirical evidence from case studies and data analysis will be examined to illustrate the tangible impact of small businesses on GDP growth. Subsequently, factors influencing the contribution of small businesses to GDP will be explored, encompassing regulatory environments, access to finance, technology adoption, and entrepreneurship culture. Finally, the report will conclude

with policy implications and recommendations for policymakers, emphasizing the importance of supporting small businesses to foster economic development.

Small Businesses and Economic Landscape

Small businesses represent a diverse array of enterprises, often characterized by their relatively small size, limited scale of operations, and typically fewer employees compared to larger corporations [2]. While there is no universally accepted definition of small businesses, they are commonly classified based on criteria such as annual revenue, number of employees, or industry sector. For instance, the U.S. Small Business Administration defines small businesses as those with fewer than 500 employees for most manufacturing and mining industries and less than \$7.5 million in average annual receipts for non-manufacturing industries [3].

The importance of small businesses in the economy cannot be overstated. These enterprises serve as engines of economic growth, fostering innovation, job creation, and wealth generation. Small businesses contribute significantly to Gross Domestic Product (GDP), both directly through their economic activities and indirectly through their multiplier effects on other industries [4]. Moreover, small businesses play a vital role in promoting social mobility by providing opportunities for entrepreneurship and upward economic mobility, particularly for marginalized communities and disadvantaged individuals.

In comparison to larger enterprises, small businesses exhibit distinct characteristics and advantages. While large corporations may have greater financial resources and economies of scale, small businesses often possess agility, adaptability, and a closer connection to local markets. Small businesses are known for their ability to innovate rapidly, respond swiftly to changing market conditions, and provide personalized products or services tailored

to the needs of their customers [2]. Additionally, small businesses are integral to fostering competition, preventing monopolistic practices, and promoting diversity in the marketplace, thereby enhancing consumer choice and welfare.

Small Businesses and National GDP: Theoretical Framework

The relationship between small businesses and Gross Domestic Product (GDP) is complex and multifaceted, with small businesses exerting a significant influence on national economic output through various channels. At its core, the contribution of small businesses to GDP stems from their role as engines of economic activity, driving production, consumption, and investment within an economy [5]. Small businesses contribute to GDP directly through their production of goods and services and indirectly through their interactions with other sectors of the economy, such as supply chain linkages and employment effects.

Economic theories offer insights into the significance of small businesses in GDP growth. One such theory is the theory of entrepreneurial ecosystems, which posits that vibrant entrepreneurial ecosystems characterized by the presence of diverse and dynamic small businesses foster innovation, productivity, and economic growth [6]. Small businesses, as key components of entrepreneurial ecosystems, contribute to GDP growth by generating new ideas, products, and processes, thereby enhancing productivity and competitiveness.

Moreover, the theory of endogenous growth emphasizes the role of innovation and technological progress in driving long-term economic growth [7]. Small businesses, particularly innovative startups and high-growth ventures, serve as catalysts for technological innovation and diffusion, leading to productivity gains and ultimately contributing to GDP growth. By introducing disruptive technologies, entering new markets, and challenging incumbent firms, small businesses stimulate economic dynamism and enhance the overall efficiency of the economy.

Several economic indicators provide insights into the relationship between small businesses and national GDP. Key indicators include measures of entrepreneurship activity, such as business startup rates, self-employment rates, and business ownership rates [8]. Additionally, indicators related to small business performance, such as employment growth, revenue growth, and productivity levels, offer valuable insights into the contribution of small businesses to GDP growth and economic development

- According to the U.S. Small Business Administration, small businesses accounted for 44% of U.S. economic activity (GDP) in 2014. [9]
- In the European Union, Small and Medium-Sized Enterprises (SMEs) generated approximately 56% of total value added in the non-financial business economy in 2017. [10]
- Research by the Global Entrepreneurship Monitor (GEM) found that countries with higher levels of entrepreneurial activity tend to have higher GDP growth rates. [11]

These statistics provide empirical evidence of the significant contribution of small businesses to national GDP and support the theoretical framework outlined here.

In summary, small businesses play a crucial role in shaping national GDP through their contributions to production, innovation, and entrepreneurship. Economic theories highlight the significance of small businesses in driving economic growth, while relevant economic indicators offer empirical evidence of their impact on GDP.

Empirical Evidence: Case Studies and Data Analysis

• **Case Study:** Small Businesses in the United States: In the United States, small businesses have long been recognized as key drivers of economic growth. For instance, a study by the Kauffman Foundation found that between 1980 and 2005, all net new job creation in the U.S. occurred in firms less than five years old, predominantly small businesses [12]. Additionally, research by the U.S. Small Business Administration revealed that small businesses accounted for 44% of U.S. economic activity (GDP) in 2014 [9]. These case studies underscore the substantial contribution of small businesses to national GDP and employment generation in the United States.

• **Statistical Data Analysis:** Analyzing statistical data further confirms the significant role of small businesses in GDP growth. For instance, Eurostat data shows that in the European Union, SMEs generated approximately 56% of total value added in the non-financial business economy in 2017 [10]. Moreover, research by the Global Entrepreneurship Monitor (GEM) found that countries with higher levels of entrepreneurial activity tend to have higher GDP growth rates [11]. These statistical findings provide empirical evidence of the strong correlation between small business activity and national GDP growth.

• **Examination of Trends Over Time:** Examining trends over time reveals the evolving dynamics of small businesses' contribution to GDP growth. For example, a study by the OECD found that while the contribution of SMEs to employment remained stable between 2010 and 2018, their contribution to value added (GDP) increased in most OECD countries during the same period [13]. This trend suggests that small businesses are becoming increasingly efficient and productive, leading to a greater impact on national GDP over time.

In summary, case studies and statistical data analysis provide compelling evidence of the substantial contribution of small businesses to national GDP growth across different sectors and countries. Moreover, examining trends over time reveals the evolving nature of this contribution, highlighting the importance of ongoing research and policy support for small business development.

Factors Influencing the Contribution of Small Businesses to GDP

• **Regulation:** Regulatory environments significantly impact the ability of small businesses to thrive and contribute to GDP growth. Excessive regulatory burdens can impede entrepreneurship, innovation, and business expansion, thus hindering the overall economic output [14]. For instance, complex licensing procedures, bureaucratic hurdles, and stringent labor regulations may disproportionately affect small businesses, stifling their growth and productivity. Conversely, regulatory reforms aimed at streamlining business procedures, reducing compliance costs, and enhancing the ease of doing business can spur entrepreneurial activity and stimulate GDP growth [15].

• **Access to Finance:** Access to finance is critical for small businesses to invest in expansion, innovation, and productivity-enhancing activities. However, small businesses often face challenges in accessing capital due to factors such as limited collateral, lack of credit history, and risk aversion among lenders [16]. Inadequate access to finance constrains the growth potential of small businesses and hampers their ability to contribute significantly to GDP. Policies aimed at improving financial inclusion, such as microfinance programs, venture capital initiatives, and government-backed loan guarantees, can enhance access to finance for small businesses, thereby fostering entrepreneurship and economic growth [15].

• **Technology Adoption:** Technology plays a transformative role in enhancing the competitiveness and productivity of small businesses. Adopting digital technologies, such as e-commerce platforms, cloud computing, and data analytics, enables small businesses to reach new markets, streamline operations, and innovate products and services [17]. However, disparities in technological capabilities and digital infrastructure may widen the productivity gap between small and large firms. Policies promoting digital literacy, technology training programs, and investment in broadband infrastructure can facilitate technology adoption among small businesses, unlocking their potential to contribute more substantially to GDP growth [15].

• **Entrepreneurship Culture:** The prevailing entrepreneurship culture within a society influences the propensity of individuals to start and grow small businesses. Societal attitudes towards risk-taking, failure tolerance, and entrepreneurial success shape the entrepreneurial ecosystem and its impact on GDP growth [8]. Cultivating an entrepreneurial culture involves fostering a supportive environment for entrepreneurship through initiatives such as education and training programs, mentorship networks, and recognition of entrepreneurial achievements. By nurturing a vibrant entrepreneurship culture, policymakers can stimulate entrepreneurial activity, unleash the innovative potential of small businesses, and drive economic growth [15].

Factors such as regulation, access to finance, technology adoption, and entrepreneurship culture significantly influence the ability of small businesses to contribute to GDP. Regulatory reforms, financial inclusion initiatives, technology policies, and entrepreneurship promotion strategies are essential for unleashing the full economic potential of small businesses and fostering sustainable GDP growth.

Factors	Statistical Data
Access to Finance	- In 2017, approximately 1.7 billion adults worldwide remained unbanked, lacking access to formal financial services.
Technology Adoption	- Only 17% of small and medium-sized enterprises (SMEs) engage in e-commerce activities compared to 39% of large enterprises in the European Union.

Policy Implications and Recommendations

• **Evaluation of Existing Policies:** Existing policies aimed at supporting small businesses vary across different countries and regions. While some policies have been successful in fostering entrepreneurship and facilitating small business growth, others may fall short of their intended objectives. For instance, research by Storey suggests that targeted financial support programs, such as loan guarantees and venture capital schemes, have proven effective in enhancing access to finance for small businesses and stimulating economic activity [18]. However, regulatory burdens and administrative complexities may undermine the effectiveness of such policies, highlighting the need for ongoing evaluation and refinement.

• **Recommendations for Policymakers:** To enhance the contribution of small businesses to GDP, policymakers should consider a multifaceted approach addressing various factors influencing small business growth. Firstly, streamlining regulatory frameworks and reducing administrative burdens can create a more conducive business environment for small enterprises. For example, simplifying licensing procedures, reducing compliance

costs, and enhancing regulatory transparency can facilitate entrepreneurship and promote small business development [19]. Additionally, policymakers should prioritize initiatives aimed at improving access to finance for small businesses, such as expanding microfinance programs, supporting alternative financing mechanisms, and fostering collaboration between financial institutions and small business owners [16]. Furthermore, investing in technology infrastructure and digital literacy programs can empower small businesses to leverage digital technologies, enhance their competitiveness, and expand their market reach [20].

• **Suggestions for Future Research:** Future research in this area should focus on evaluating the impact of policy interventions on small business outcomes and GDP growth. Longitudinal studies tracking the implementation of specific policy measures and their effects on small business performance can provide valuable insights into the effectiveness of different policy approaches. Moreover, comparative analyses across countries and regions can shed light on best practices and lessons learned in supporting small businesses and promoting economic growth. Additionally, research exploring the role of entrepreneurship education, mentorship programs, and ecosystem support initiatives in fostering small business development can inform the design of comprehensive policy frameworks [8].

In summary, policymakers should evaluate existing policies supporting small businesses, implement targeted measures to enhance their contribution to GDP, and prioritize research efforts aimed at informing evidence-based policy decisions.

Conclusion

In conclusion, this report has explored the multifaceted role of small businesses in driving national GDP growth and the factors influencing their contribution to the economy. Through an examination of empirical evidence, theoretical frameworks, and policy implications, several key findings have emerged.

Summary of Key Findings

- Small businesses constitute a significant proportion of economic activity worldwide, contributing to job creation, innovation, and wealth generation.
- Economic theories such as the theory of entrepreneurial ecosystems and endogenous growth highlight the importance of small businesses in driving long-term economic growth.
- Factors such as regulation, access to finance, technology adoption, and entrepreneurship culture significantly influence the ability of small businesses to contribute to GDP growth.
- Existing policies supporting small businesses vary in their effectiveness, necessitating ongoing evaluation and refinement.

Reflection on the Significance of Small Businesses

Small businesses play a pivotal role in driving national GDP growth, serving as engines of innovation, productivity, and economic dynamism. Their agility, adaptability, and entrepreneurial spirit contribute to economic resilience and competitiveness, particularly in times of economic uncertainty. By fostering entrepreneurship, creating jobs, and stimulating local development, small businesses contribute to the overall prosperity and well-being of society.

Final Thoughts on the Importance of Supporting Small Businesses

Supporting small businesses is essential for sustainable economic development and inclusive growth. Policymakers must prioritize initiatives aimed at creating a conducive business environment for

small enterprises, including regulatory reforms, access to finance programs, and technology adoption incentives. By investing in the growth and success of small businesses, policymakers can unlock their full potential to drive economic growth, reduce inequality, and build vibrant, resilient economies for the future.

In conclusion, small businesses are not only the backbone of economies but also catalysts for innovation, job creation, and prosperity. It is imperative to recognize and support their vital role in driving national GDP growth and advancing socioeconomic progress.

Appendices

Appendix A: Definitions of Small Businesses

The definition of small businesses varies across countries and industries. Here are some commonly used criteria for defining small businesses

Number of Employees: Small businesses typically have a limited number of employees. For example, in the United States, the Small Business Administration defines small businesses as those with fewer than 500 employees for most manufacturing and mining industries.

Annual Revenue: Small businesses may be defined based on their annual revenue or turnover. For instance, in the European Union, Small and Medium-Sized Enterprises (SMEs) are defined as those with annual turnover not exceeding €50 million.

Industry Classification: Small businesses may be classified based on industry sectors. For example, certain industries may have specific criteria for defining small businesses, such as retail, manufacturing, or services.

Appendix B: Examples of Small Business Support Programs

Loan Guarantee Programs: Government-backed loan guarantee programs provide financial institutions with assurances against default, enabling them to extend credit to small businesses with limited collateral or credit history.

Microfinance Initiatives: Microfinance programs offer small loans and financial services to microentrepreneurs and small business owners in underserved communities, facilitating access to capital and promoting entrepreneurship.

Entrepreneurship Training and Mentorship: Entrepreneurship training programs and mentorship initiatives provide aspiring entrepreneurs and small business owners with guidance, resources, and networking opportunities to develop their business skills and enhance their chances of success.

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