

Small Business Trends in Chattanooga

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Summary

This paper looks at small business trends in Chattanooga relative to Tennessee and the United States. In 2023, 72.3 percent of Chattanooga's firms were small, while corresponding numbers in Tennessee and the United States were 81.2 percent and 87.4 percent. In the same year, 14.6 percent of Chattanooga's private employment was in small firms, whereas 16.7 percent of private employment in the United States was. Small firms are most prominent in Chattanooga's Other Services and Construction industries, and least prominent in its Transportation and Warehousing, Manufacturing, and Management industries. Small firms account for 20 percent or more of employment in five industries, and less than 6 percent of employment in six industries. Finally, Chattanooga's small firms tend to have more employees than do those in the United States as a whole, and this difference has been rising.

Introduction

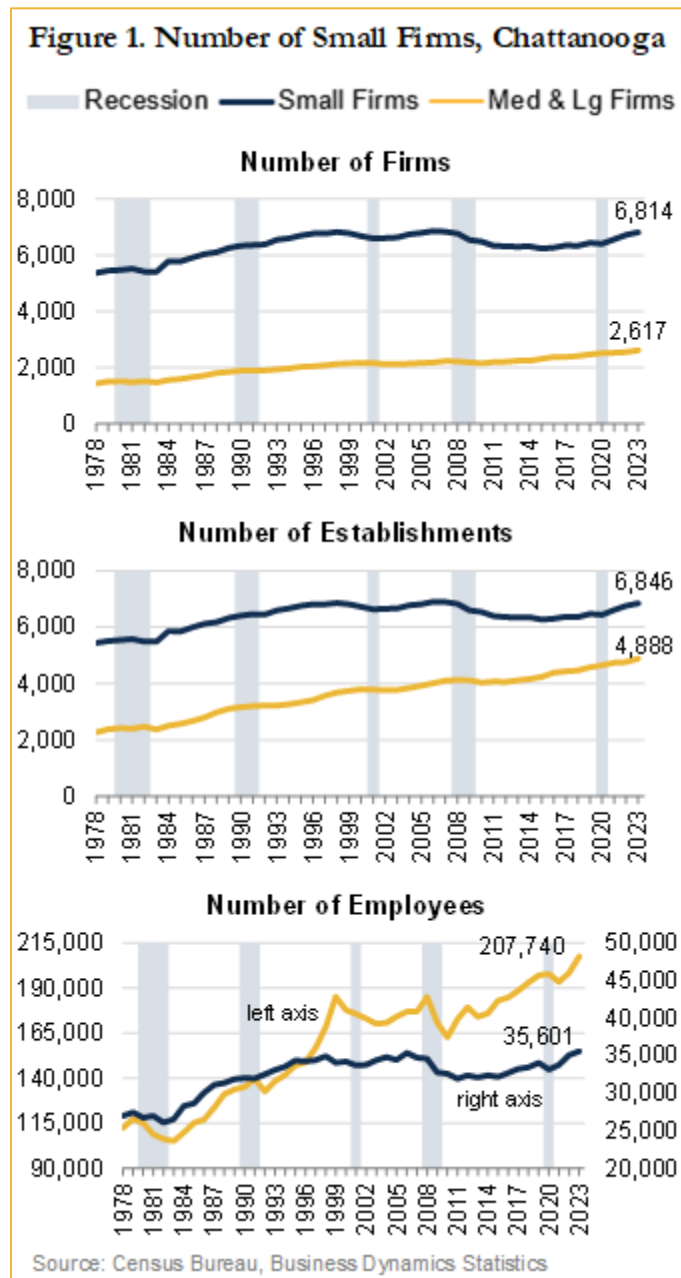
This paper looks at the evolution and current composition of small businesses in the Chattanooga Metropolitan Statistical Area (MSA). It pays particular attention to the contributions of small businesses to the numbers of firms, establishments, and employees in Chattanooga relative to Tennessee and the United States. The data for the analysis are from the Census Bureau's Business Dynamics Statistics (BDS), which provides estimates of the number of private-sector firms in three size categories: those with 1 to 19 employees, 20 to 499 employees, and 500 or more employees. Small businesses are taken to be those firms with fewer than 20 employees.ⁱ

A significant amount of research has looked at small businesses from a national perspective, where small firms in 2023 accounted for more than 87 percent of all firms, two-thirds of all establishments, and almost 17 percent of all employees.ⁱⁱ A dominant theme of the research is that there is a great deal of variety among small firms in terms of their purpose, industry, and size. As outlined by Hurst and Pugsley (2011), most owners of small firms are motivated by a mix of income needs, personal freedom, and flexibility. These *lifestyle entrepreneurs* are typically satisfied with the size of their business, which is usually focused on providing existing services rather than creating or innovating new products. A minority of small businesses are owned by *transformative entrepreneurs* who view their small firms as nascent large businesses with products or services developed by the owners.ⁱⁱⁱ These firms, which are typically small and young, are a significant source of the innovation and growth that can drive growth in the economy as a whole.^{iv}

The two types of small businesses benefit local economies in different ways. First and foremost, they provide goods and services to community members and livelihoods for their owners and employees. In addition, small, lifestyle businesses can be sources of poverty reduction, not just for their owners, but also for their communities more broadly.^v Recent research has looked at their role in vitalizing urban neighborhoods, particularly in minority-majority areas of cities.^{vi} These benefits are quite different from those generated by transformative small businesses, which can be significant sources of job creation, economic diversification, and knowledge spillovers.

Policies toward small businesses should account for the differences between lifestyle and transformative entrepreneurs in their purpose, benefits, and needs. Lifestyle entrepreneurs might benefit from local deregulation, lighter occupational-licensing requirements, or greater credit availability. Transformative small businesses, on the other hand, might benefit from targeted R&D support, innovation incentives, access to a pool of specialized labor, or access to venture capital.

Note that the data used in this analysis does not separate firms into the two entrepreneurship types, but it does allow for a breakdown by broad industries. Transformative small firms tend to be located in (1) the Professional, scientific, and technical services industry and its computer systems design, engineering services, and scientific research sectors; (2) the Manufacturing industry and its advanced equipment, electronics, pharmaceuticals, and medical device sectors; and (3) the Information industry and its software publishing, data hosting, and internet platform sectors. This paper is a first step in understanding how small businesses contribute to the Chattanooga economy. Subsequent research will go into further detail on the dynamics of small businesses in the local economy and on the policies that might assist them.



Small Firms and Their Industries

All Industries

Figure 1 shows how the number of firms in Chattanooga has changed over time and over fluctuations in the business cycle. The number of small firms changes alongside the number of medium and large firms, but at quite different rates. In 2023, there were 6,814 small firms in Chattanooga, a 27 percent increase over the 5,271 small firms in 1978. Over the same period, the number of medium and large firms grew by 82 percent from 1,439 to 2,617.

The middle panel shows how the number of establishments has grown with the number of firms, although at a faster rate.^{vii} The number of establishments for medium and large firms grew by 117 percent between 1978 and 2023, indicating that firms became larger over time. Small firms rarely have more than one establishment, so the number of small-firm establishments grew at about the same pace as the number of small firms. The third panel shows that small firms have comprised a decreasing share of employment in Chattanooga

over time. In 2023, small firms accounted for 35,601 employees, a 32 percent increase compared to 1978. This was a much smaller increase than for medium and large firms, which saw an increase of 85 percent over the period, and exceeded 200 thousand in 2023.

The growth in firms, establishments, and employees was far from steady, and recessions tended to slow it down or even decrease the number of firms of all sizes. The recession of 2008-9 was particularly devastating for small firms: The number of small firms kept falling until 2015, when there were almost 9 percent fewer of them than in 2007. Recovery was extremely slow and by 2023 the number of small firms still had not returned to its pre-recession level. Medium and large firms, on the other hand, saw a short and shallow recession followed by a rapid recovery. By 2011 there were 1.5 percent fewer medium and large firms than in 2007, and full recovery to the pre-recession number occurred by 2013.

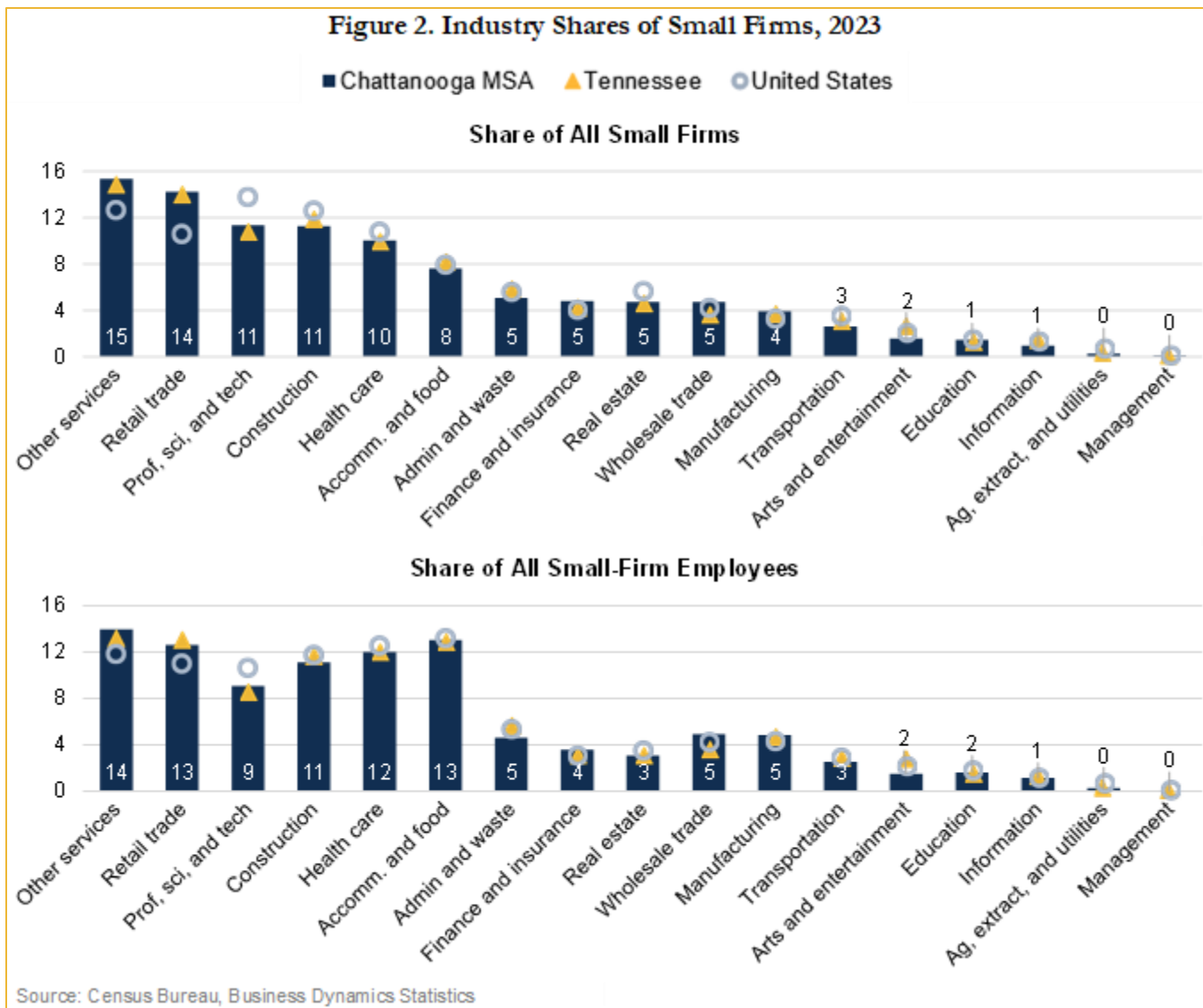
As occurred for the number of small firms, the two most recent recessions were quite different for small-firm employment than for medium-and-large-firm employment. Small-firm employment peaked in 2007 and by 2011 it was 8 percent lower. Recovery was slow, and it took until 2022 for small-firm employment to reach its 2007 level. In contrast, employment at medium and large firms experienced a deeper recession and quicker recovery. Employment peaked in 2008 and declined sharply over the next two years. The 12 percent loss was not reversed until 2017.

Although the substantial financial support from the Federal government prevented significant firm closure during the COVID-19 recession of 2020, employment was affected. There were 900 (2.7 percent) fewer small-firm employees in 2020 than in 2019, but a strong recovery was underway through 2021. Employment at medium and large firms, on the other hand, was little different in 2020 than in 2019, but was 4,400 (1.9 percent) lower in 2021.

Seventeen Industries

The BDS data is also provided for the 19 private industries described in Appendix A. Because of privacy standards, data for the first three Chattanooga industries frequently have missing values for small firms, so this analysis combines them into a single industry: Agriculture, extraction, and utilities. The top panel of Figure 2 presents in decreasing order the share of Chattanooga's small firms that are in each industry, along with symbols showing the corresponding numbers for Tennessee and the United States. The bottom panel of the figure shows the same information for the shares of small-firm employment in the industries.

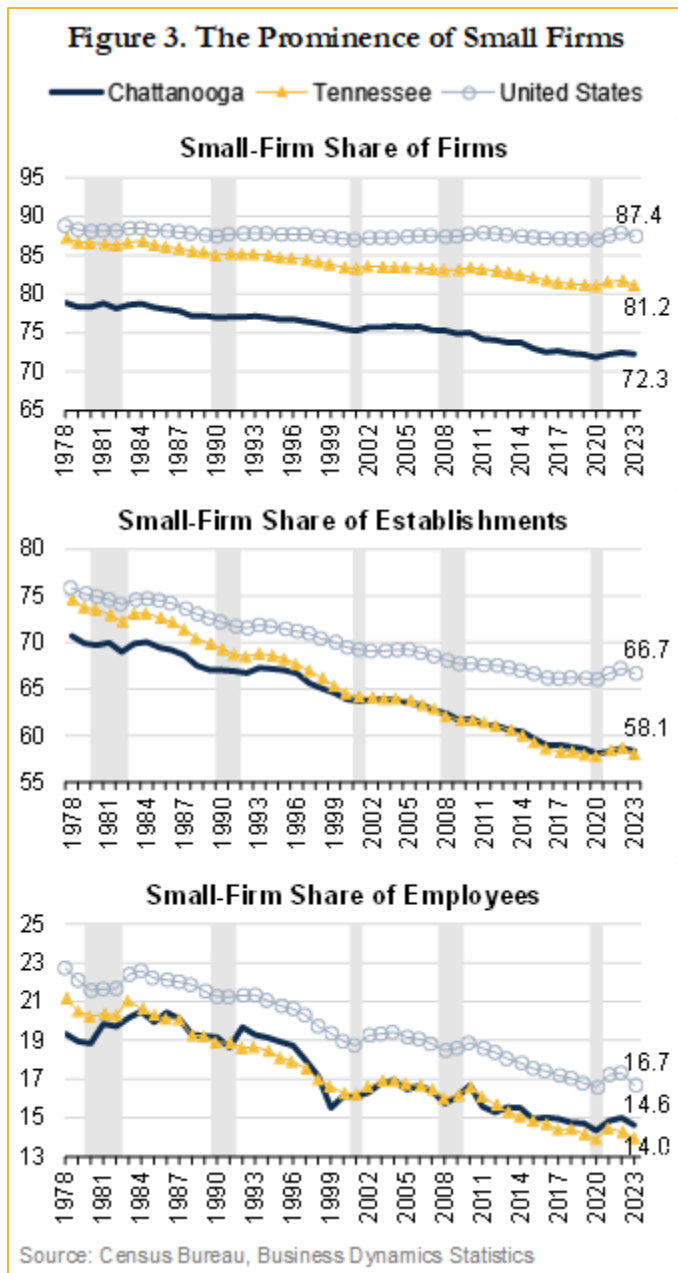
About 69 percent of Chattanooga's small firms are in just six industries: Other services; Retail trade; Professional, scientific, and technical services; Construction; Health care and social services; and



Accommodation and food services. These industries also illustrate the differences between Chattanooga and the rest of the country. Although the industry shares of Chattanooga's small firms differ little from Tennessee's, Chattanooga has much larger shares of small firms than the rest of the country does in Other services and Retail trade, and notably smaller shares in Professional, scientific, and technical services; Construction; Health care and social assistance; and Real estate. The differences in terms of shares of employees are much smaller than in terms of firms, indicating that small firms in Chattanooga tend to have relatively more employees. An implication of these differences is that, because of its relatively small share of small firms in the Professional, scientific, and technical industry, Chattanooga might have relatively fewer potentially transformative small firms.

Appendices B and C illustrate how this picture changed somewhat in recent years. Most notably, the retail industry reversed course since 2020 in Chattanooga and has become increasingly important for small firms,

in contrast with trends elsewhere. Among the other large industries for small firms, Construction and Accommodation and food have seen their employment shares increase since 2013, while the share in Health care and social services decreased much more in Chattanooga and Tennessee than for the country overall. Among the smaller industries, the share of small firms in Chattanooga's Arts and entertainment industry did not change despite the significant increases in Tennessee and the United States. On the other hand, the Education industry in Chattanooga saw a much larger increase than elsewhere.



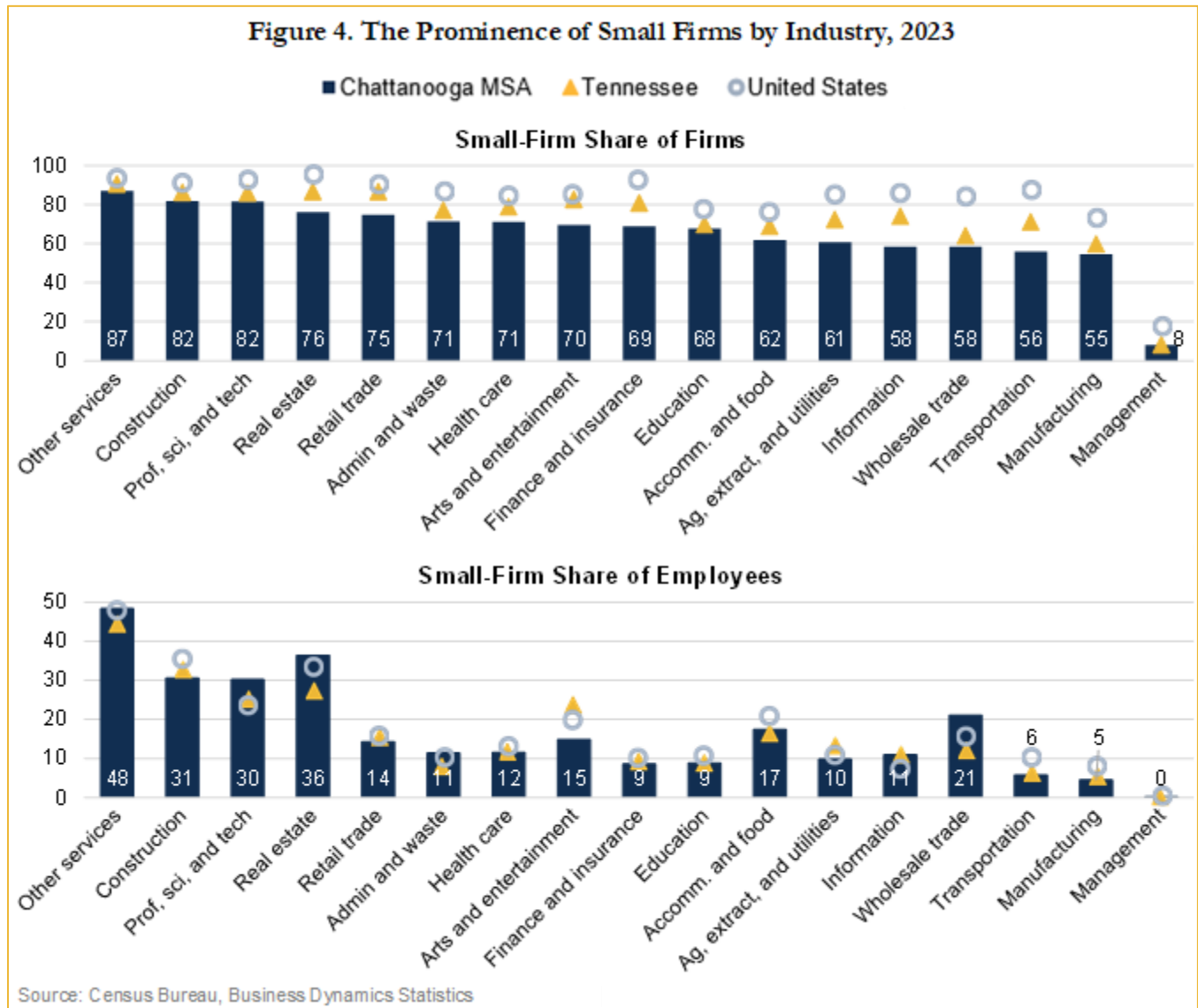
The Prominence of Small Firms

A common and useful way to highlight the prominence of small firms is to measure them as their share of the total. As shown by the top panel of Figure 3, 72.3 percent of the firms in Chattanooga in 2023 were small, a decrease from about 79 percent in 1978. The panel also shows that Chattanooga's small-firm share was well below that of Tennessee and the rest of the country over the entire period. Further, the national share of small firms barely budged between 1978 and 2003, falling by less than a percentage point from 88.3 percent to 87.4 percent. Tennessee's small-firm share was about 8 to 9 percentage points above Chattanooga's throughout the period, and it fell at almost the same rate as Chattanooga's.^{viii}

The picture is somewhat different for establishments. Small-firm establishments make up 58.1 percent of all establishments in both Chattanooga and Tennessee, and two-thirds of those in the United States as a whole. These shares have been trending downward for all three areas, as has the small-firm employment share. In

Chattanooga in 2023, small firms provided 14.6 of all private sector jobs, a slightly higher share than in Tennessee, and a little more than 2 percentage points lower than the nation as a whole.^{ix}

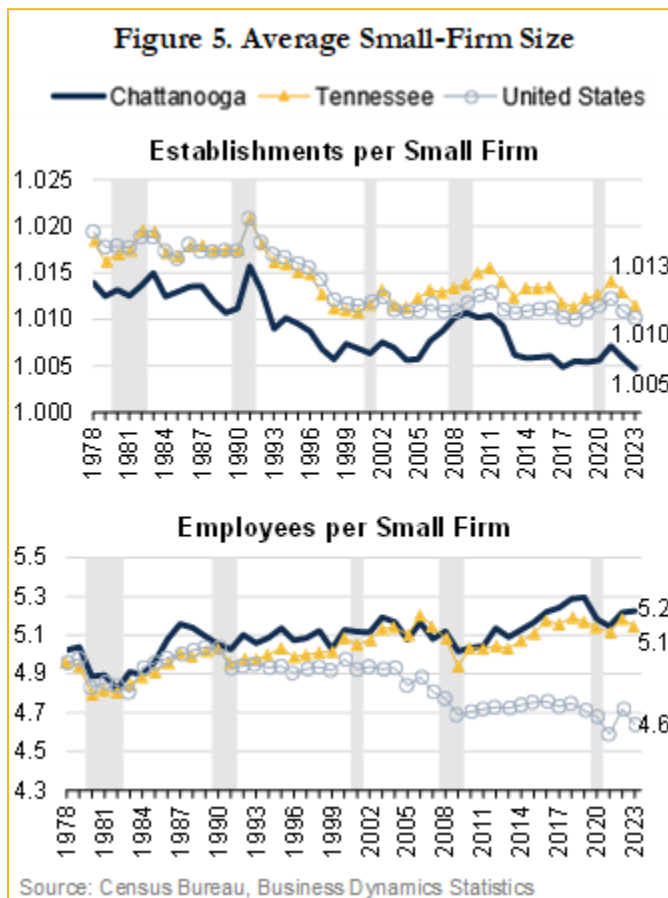
Chattanooga's small-firm share of firms differed a great deal across industries and was below that of the United States and Tennessee for all 17 of them. As shown in Figure 4, the highest small-firm shares of firms were in Other services; Construction; Professional, scientific, and technical services; Real estate; and Retail trade. These were also where the share was highest for Tennessee and the United States, although Finance and insurance was also among the most prominent for the United States. The lowest shares for all three areas were in Manufacturing and Management. Note that four of the six industries with the lowest shares for Chattanooga had some of the highest shares for the United States.



Small-firm shares of employment were not in the same order as the shares of firms. In five industries, small firms accounted for 20 percent or more of industry employment in Chattanooga: Other services; Construction; Professional, scientific, and technical services; Real estate; and Wholesale Trade. Small firms made up the smallest shares of Chattanooga employment in Transportation and warehousing,

Manufacturing, and Management. Note that small-firm employment shares were much more similar than firm shares across the three areas because, as discussed below, small firms in Chattanooga tended to be larger than in the other two areas.

In terms of their shares of total firms, establishments, or employees, small firms have become less prominent in the Chattanooga economy since 2013. For the most part, this trend occurred in Tennessee and the country as a whole, as shown in Appendices D and E. This trend was not consistent across industries within the areas, however. Several industries bucked the trend and either saw their small-firm shares of firms and employees rise over time, if only by a little: Administration and waste, Education, Accommodation and food, Information, and Wholesale trade. Mirroring what happened with its share of small-firm employment, small firms in Retail trade became more prominent in their industry since the COVID-19 pandemic. On the flip side, small firms in Health care and social services and Arts and entertainment lost prominence much faster than did small firms overall.



Small-Firm Size

Chattanooga has experienced opposing trends when it comes to the average size of its small firms. As the top panel of Figure 5 shows, the average number of establishments for a small firm in Chattanooga has fallen over time and was lower than in Tennessee and the United States over the entire period. These are very small numbers, however, as few small firms even have more than one establishment. Nevertheless, it is less likely to happen in Chattanooga and the likelihood has been falling. One interesting detail in the figure is that the average number of establishments tends to rise during recessions and fall during expansionary periods. This is not because firms add establishments during recessions, but because firms

with only one establishment are more likely to go out of business. And perhaps surviving firms absorb establishments of exiting firms. During expansions, the new firms that enter are likely to have one establishment, thereby reducing the average.

The second panel shows that small firms in Chattanooga and Tennessee have been growing in terms of their number of employees, especially during the period from 2010 to 2019. Much of this was driven by an increase in the share of small firms in Chattanooga in the Accommodation and food industry, which has the highest average employment. This trend toward larger small firms was the opposite of what happened nationally, where the average small firm in 2023 was about six tenths of an employee smaller than in Chattanooga.

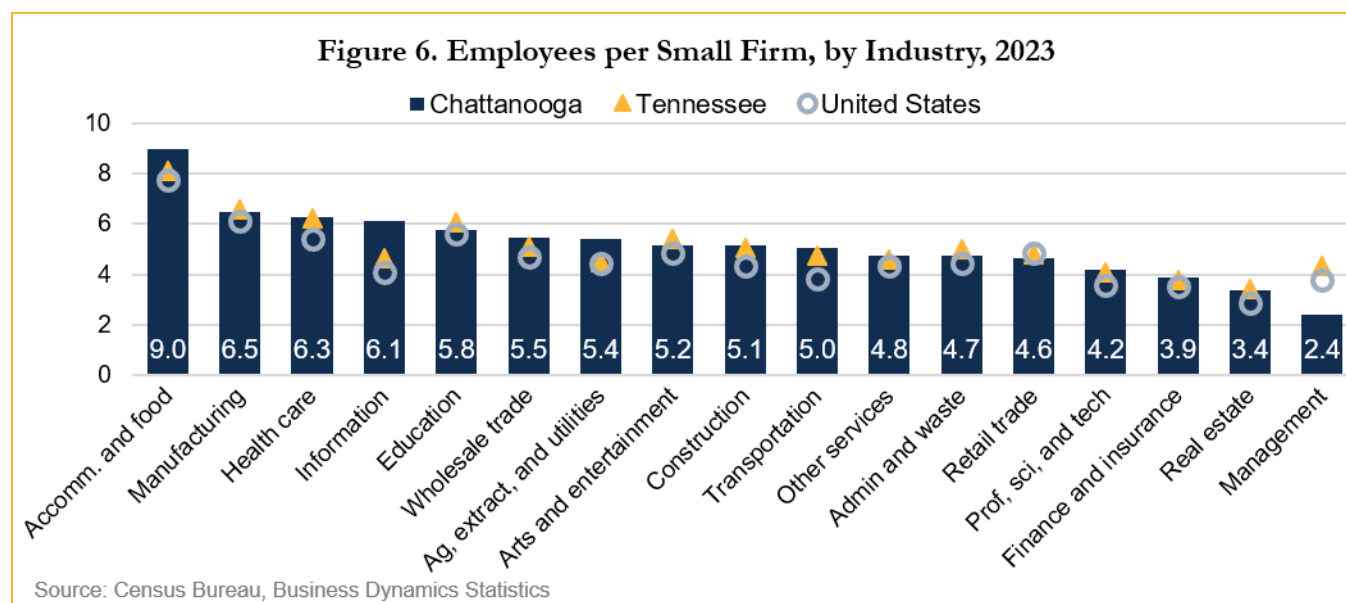


Figure 6 shows how the average number of employees at small firms differed across industries in 2023. By far, the largest small firms in Chattanooga were in the Accommodation and food industry, followed by Manufacturing, Health care, Information, and Education. The ranking was the similar for Tennessee and the United States, with the main differences being the relatively large size of small firms in Chattanooga's Information industry. The smallest small firms in Chattanooga were in Management; Real estate; Finance and insurance, and Professional, scientific, and technical services. Notice that the average small firm in Chattanooga is larger than in the United States for all but two industries, Retail trade and Management.

Appendix F shows how trends in small-firm size have differed across industries since 2013.^x As already noted, small firms in the Accommodation and food industry tended to have the most employees in 2023, which was a full employee more than in 2020, largely following state and national trends. Small firms in Manufacturing also grew, ending the period half an employee larger. The biggest changes in average small-firm size in Chattanooga occurred in Information and Agriculture, extraction, and utilities, although the latter appears to be due to a classification change for some firms rather than an increase in size of existing firms. Minor trends occurred in Health care and social services, where the gap in small-firm size between

Chattanooga and the United States grew, and Retail trade, where small firms caught up to their state and national counterparts. These trends, although minor, are notable because of the growing importance of Health care in the local and national economies and the increasing importance of retail trade among small firms in Chattanooga.

Summary and Conclusions

This paper analyzed small businesses in Chattanooga using data from the Census Bureau's Business Dynamics Statistics. It focused on trends since 1978 and on differences across a range of private industries. Comparisons between Chattanooga and Tennessee and the United States were of particular interest. The main findings of the analysis are:

- Small firms are much more numerous in Chattanooga than are medium and large firms, although their number has grown much more slowly. Between 1978 and 2023, the number of small firms grew by 27 percent whereas the number of medium and large firms grew by 82 percent.
- There were nearly 36 thousand employees at small firms in Chattanooga in 2023, an increase of 32 percent since 1978, although growth has been flat since the mid-1990s. Employment at medium and large firms grew by 85 percent over the period, standing at nearly 208 thousand in 2023.
- Small-firm employment in Chattanooga was hit very hard by the recession of 2008-09. The number of small-firm employees fell by 8 percent and still had not recovered fully by 2023.
- Six of 19 industries account for 68 percent of small firms and 72 percent of small-firm employment in Chattanooga: Other services; Retail trade; Professional, scientific, and technical services; Construction; and Health care and social services.
- In recent years, the shares of Chattanooga's small firms in Retail trade and Construction have been rising, while the share in Health care and social services has been falling.
- Small firms are much less prominent in Chattanooga than in Tennessee or the United States. In 2023, 72.3 percent of Chattanooga's firms were small, while corresponding numbers in Tennessee and the United States were 81.2 percent and 87.4 percent. The gap between Chattanooga and the United States has been growing over time.
- In terms of employment, small firms have remained less prominent in Chattanooga than in the United States. In 2023, 14.6 percent of Chattanooga's private employment was in small firms, compared to 16.7 percent of employment in the United States.
- For all industries, the small-firm share of firms is lower in Chattanooga than in Tennessee or the

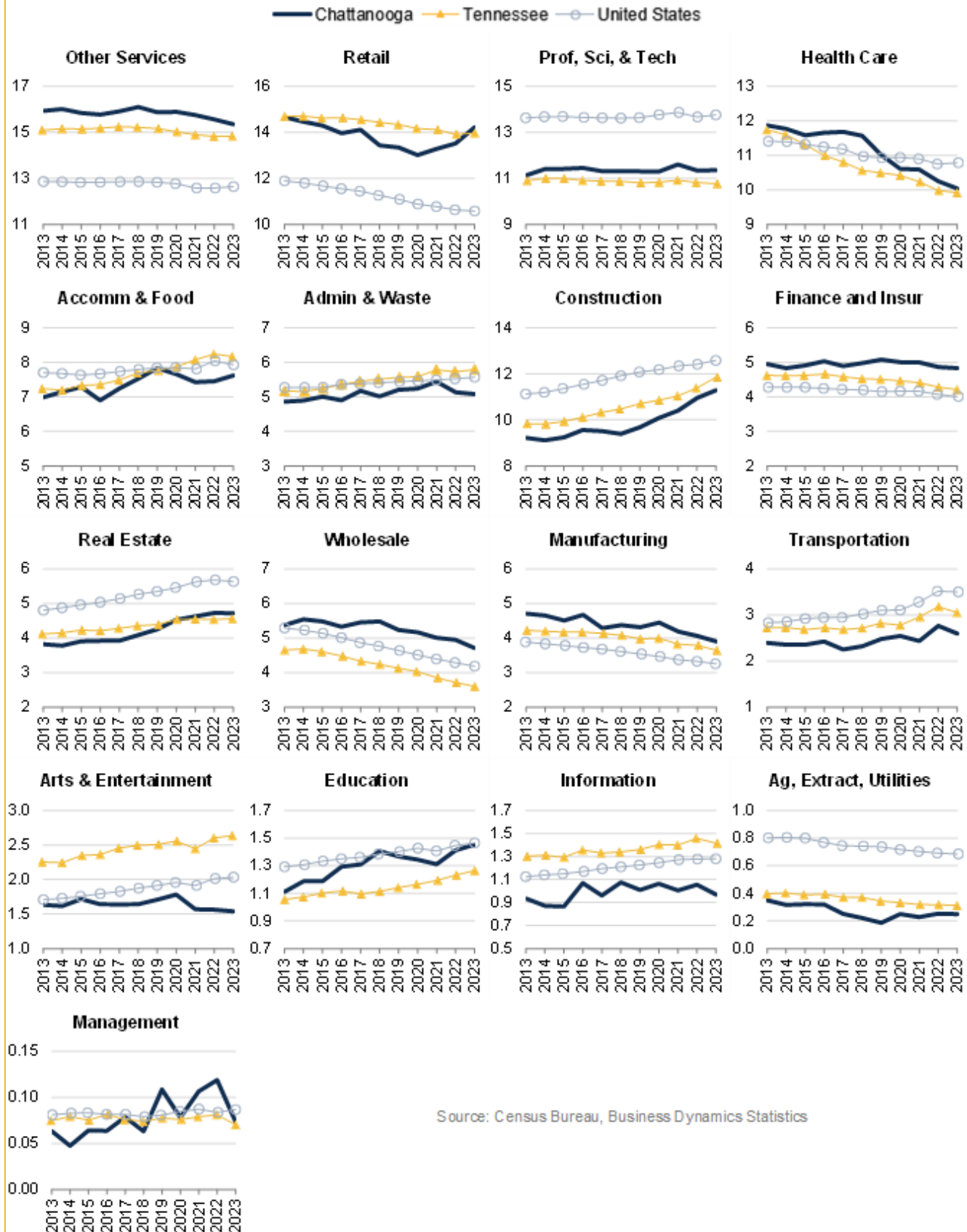
United States. This is not the case when looking at small-firm shares of employment, however. In five Chattanooga industries, the small-firm share of employment exceeds 20 percent: Other services (48 percent); Real estate (36 percent); Construction (31 percent); Professional, scientific, and technical services (30 percent); and Wholesale trade (21 percent).

- In contrast with the United States, small firms in Chattanooga have been increasing their average number of employees. In 2023, the average small firm in Chattanooga had 5.2 employees, whereas the average small firm in the United States had 4.6 employees.
- The increase in small-firm size in Chattanooga has been driven by the Accommodation and food, Manufacturing, and Health care and social services industries, which are also the industries with the largest small firms.

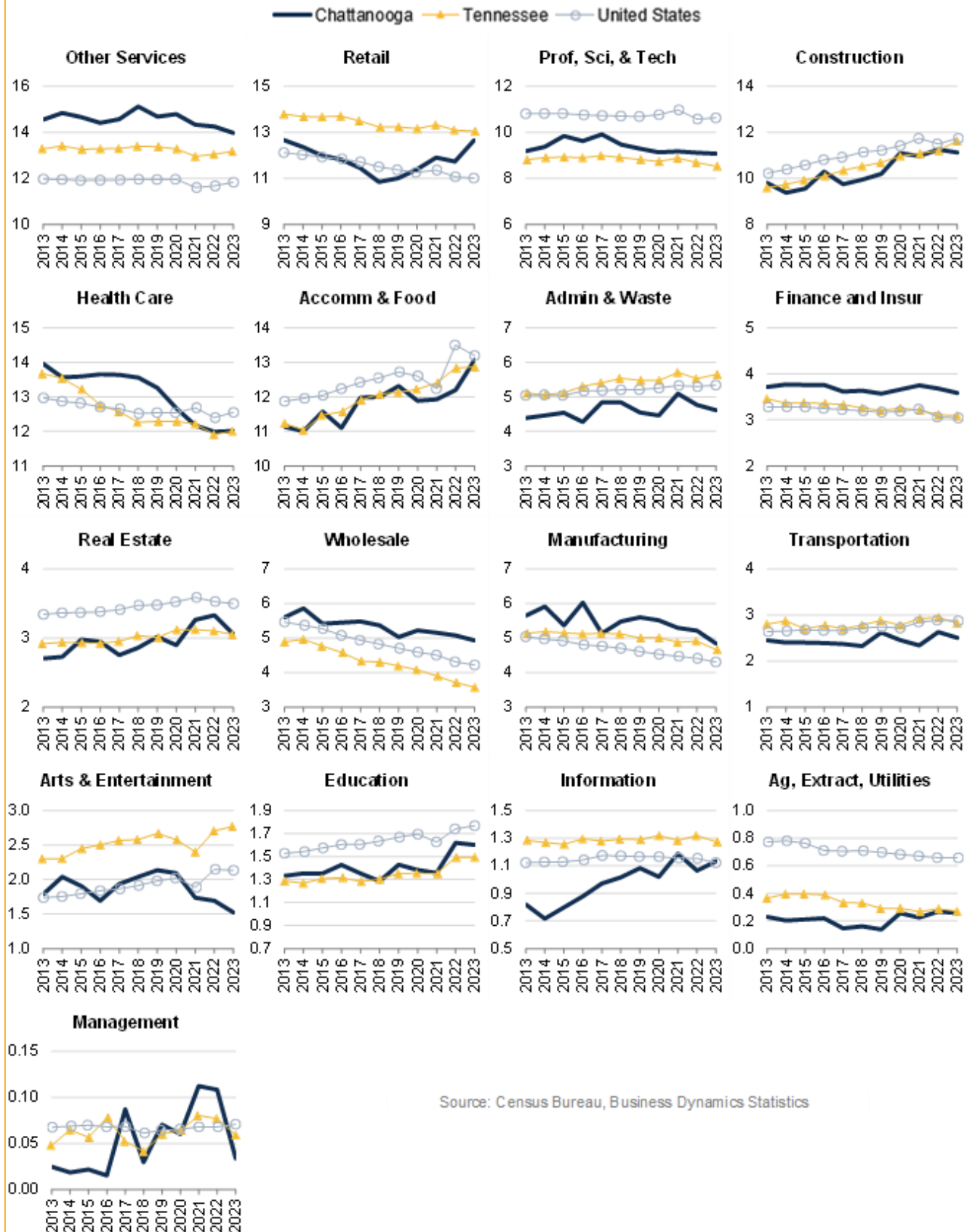
APPENDIX A: Industries and their NAICS codes

- 11 – Agriculture, Forestry, Fishing and Hunting: Growing crops, raising animals, harvesting timber, and catching fish.
- 21 – Mining, Quarrying, and Oil and Gas Extraction: Extracting naturally occurring minerals, oil, and gas.
- 22 – Utilities: Providing electric, natural gas, steam, water, and sewage removal through infrastructure.
- 23 – Construction: Building, repairing, and renovating residential, commercial, and engineering structures.
- 31-33 – Manufacturing: Transforming raw or mixed materials into new finished products.
- 42 – Wholesale Trade: Selling merchandise to other businesses, retailers, or industrial clients without heavy transformation.
- 44-45 – Retail Trade: Selling merchandise directly to the general public for personal or household use.
- 48-49 – Transportation and Warehousing: Moving passengers and cargo, and storing goods.
- 51 – Information: Producing, processing, and distributing information, data, and media content.
- 52 – Finance and Insurance: Managing money, issuing credit, banking, and underwriting insurance policies.
- 53 – Real Estate and Rental and Leasing: Buying, renting, managing, or leasing real estate property and tangible assets.
- 54 – Professional, Scientific, and Technical Services: Providing specialized professional expertise like legal, accounting, engineering, or design services.
- 55 – Management of Companies and Enterprises: Holding the securities or equity of companies to influence management decisions.
- 56 – Administrative and Support and Waste Management and Remediation Services: Providing routine support operations, security, cleaning, and waste disposal.
- 61 – Educational Services: Providing training, instruction, and schooling across various levels.
- 62 – Health Care and Social Assistance: Providing medical care, nursing, hospitals, and social welfare services.
- 71 – Arts, Entertainment, and Recreation: Operating cultural, sporting, amusement, and recreational events or facilities.
- 72 – Accommodation and Food Services: Providing lodging for travelers and preparing meals or drinks for immediate consumption.
- 81 – Other Services (except Public Administration): Providing personal care, repair services, religious organizations, and laundry services.

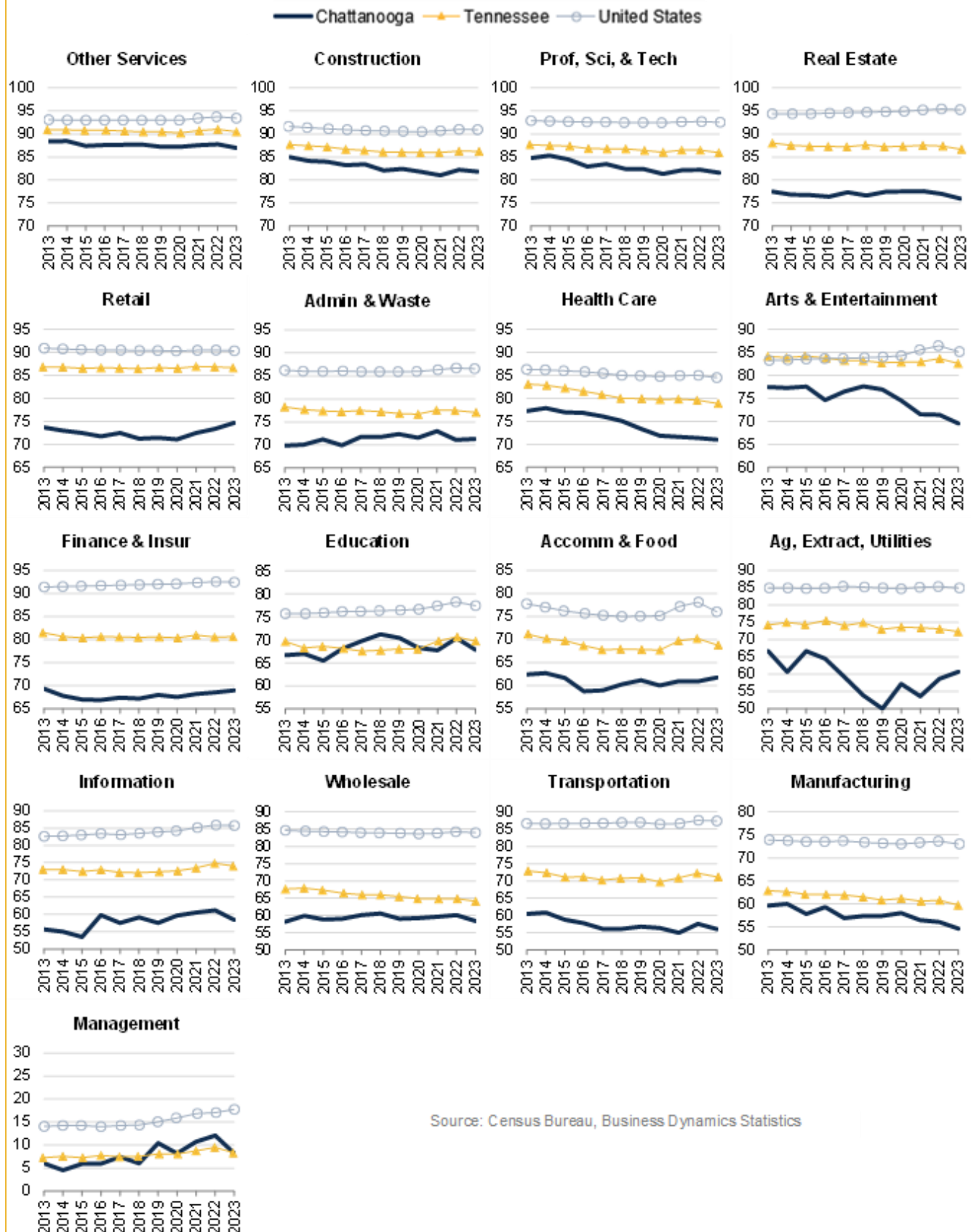
APPENDIX B. Industry Shares of Small Firms, 2013-23



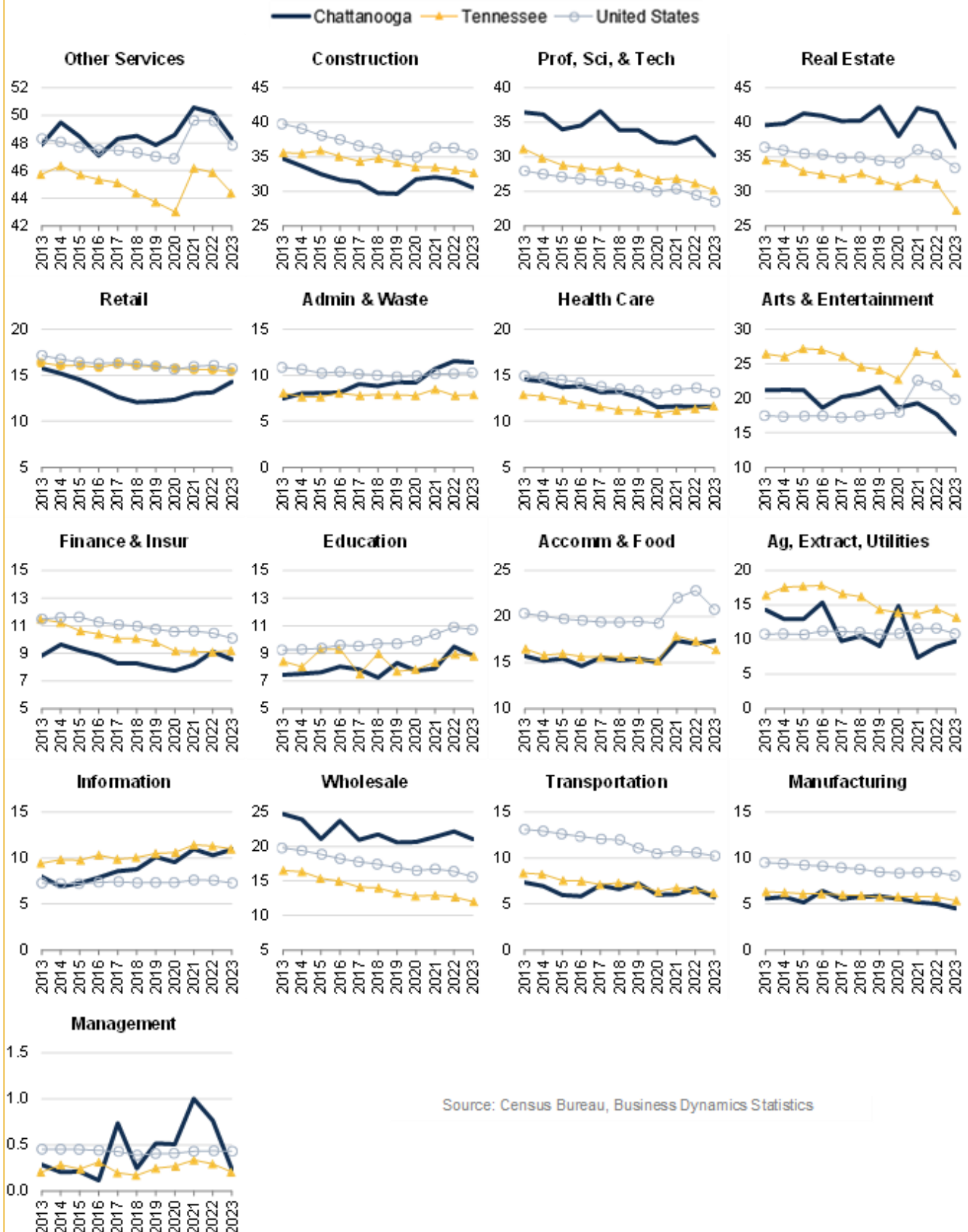
APPENDIX C. Industry Shares of Small-Firm Employees, 2013-23



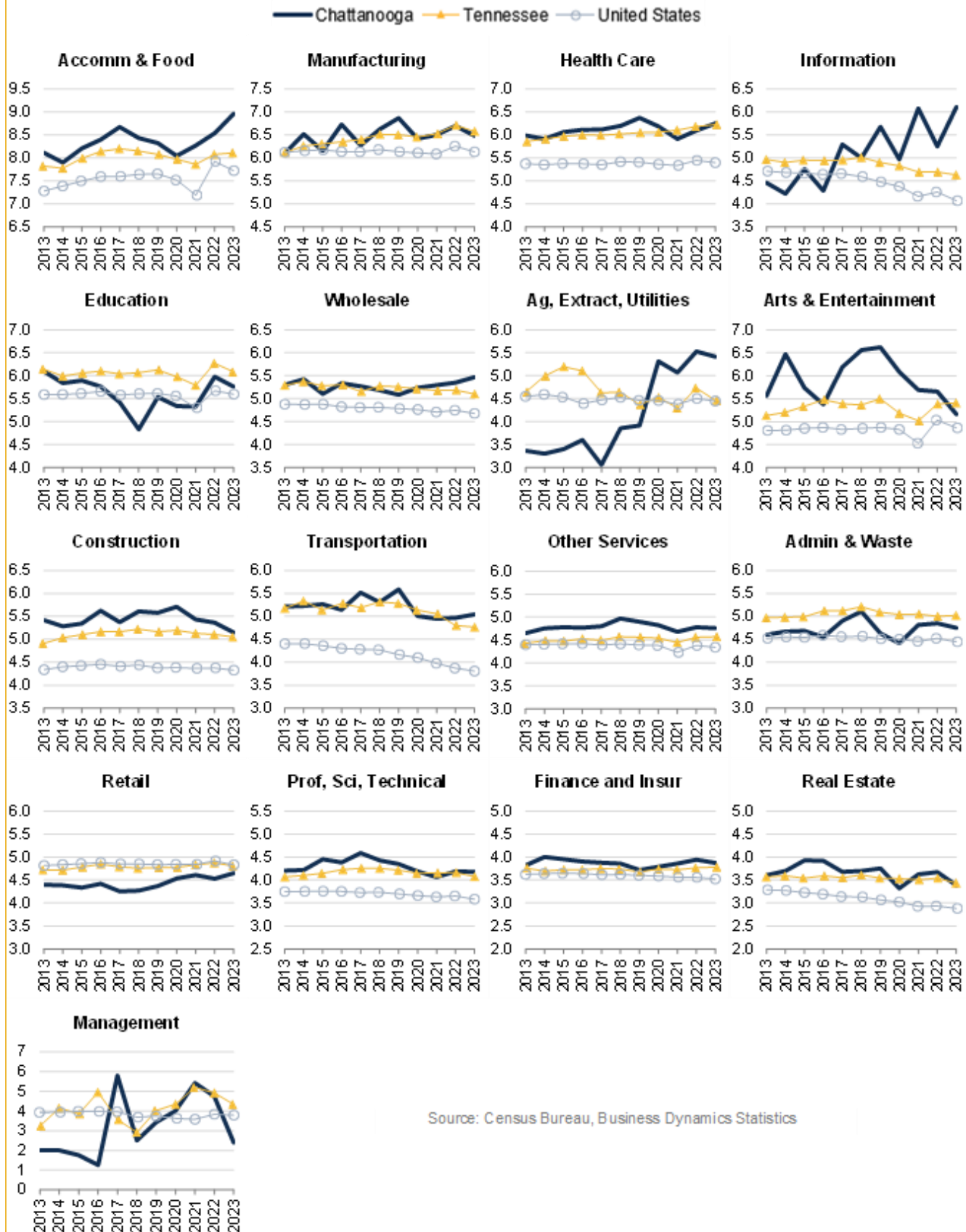
APPENDIX D. Small-Firm Share of Firms, 2013-23



APPENDIX E. Small-Firm Share of Employees, 2013-23



APPENDIX F. Average Number Employees in Small Firms, 2013-23



ENDNOTES

ⁱ Note that the Small Business Administration's definition includes all firms with fewer than 500 employees, which is far too generous to be useful. The 20-employee limit is much more common in the academic literature and is much more in line with what people consider to be small.

ⁱⁱ For a survey of recent developments and national trends for small businesses and entrepreneurs, see John Haltiwanger, 2022. "Entrepreneurship in the Twenty-First Century," *Small Business Economics*, 58, 27-40.

ⁱⁱⁱ Erik Hurst and Benjamin Wild Pugsley, 2011. "What Do Small Businesses Do?" *Brookings Papers on Economic Activity*, 42(2), 73-118. They report that 75 percent of small firms were happy with their current size, and 90 percent had no plans or desire to innovate or to develop a new product.

^{iv} The finding regarding size and age comes from John Haltiwanger, Ron S. Jarmin, and Javier Miranda, 2013. "Who Creates Jobs? Small vs. Large vs. Young," *The Review of Economics and Statistics*, 95 (2), 347-361.

^v For example, see Neil Lee and Andres Rodriguez-Pose, 2021. "Entrepreneurship and the Fight Against Poverty in U.S. Cities," *Economy and Space*, 53(1), 31-52.

^{vi} Li-Wei Chen, Saurabh A. Lall, and Peter W. Roberts, 2026. "Business Deficits in Minority Neighborhoods across the United States," *Urban Studies*, forthcoming.

^{vii} An establishment is a distinct physical site for a business, whereas a firm is a legal entity that has control over one or more establishments. A firm operates in an area if it has an establishment there, even if its legal entity is located elsewhere. In this data, the size of a firm is determined by its total employment across all of its establishments. Thus, a national firm with 1,000 employees nationwide and one 10-employee establishment in Chattanooga would be counted among Chattanooga's large firms, and its 10 employees would be counted among Chattanooga's large-firm employees.

^{viii} A major reason for Tennessee and Chattanooga to have lower shares of small firms than the United States is simply population density. Low density means that there will be a higher share of small firms providing fundamental services to local customers. High density means that more medium and large firms can take advantage of a nearby labor force and sell to customers outside the area. According to the 2020 census, the population densities of Tennessee, Chattanooga, and the United States were, respectively, 167.6, 263.3, and 93.8 people per square mile.

^{ix} It's worth noting that Chattanooga is pretty typical for a metro area in Tennessee. In 2023, the average small-firm share across the state's 11 metro area was 72 percent, while the average small-firm share of employment was 14.8 percent.

^x The differences and changes in small-firm average establishments are too small to be informative, so they have not been included.