

ECONOMIC IMPACT OF SMALL BUSINESS DEVELOPMENT CENTER

COUNSELING ACTIVITIES IN NORTHEASTERN CALIFORNIA:

2007-2008

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EXECUTIVE SUMMARY

This report analyzes the sales and employment changes and financing obtained by a sample of established businesses and pre-ventures (persons aspiring to start a business) that received five or more hours of counseling assistance (long-term clients) from the Northeastern California Small Business Development Center (SBDC) in 2007. The report also provides an estimate of the jobs saved and existing sales retained through SBDC counseling.

There were 82 responses to two mailings of a questionnaire, a 13.9% response rate. The clients surveyed represent the entire population of long-term clients (received five hours or more of counseling) of the Northeastern California SBDC in 2007. Tests indicated that the sample was large enough to obtain statistically reliable estimates, there were no differences in early or late respondents on the performance indicators analyzed that suggested an overestimation of economic impact, and the responses provided were reliable.

The sales and employment changes of the sample in 2008 (the year after receiving assistance) were compared to the average change in sales and employment of all businesses in California. The incremental improvement in the sample's performance, above the performance of the average business in California, was extrapolated across the entire long-term client population to estimate the tax revenues generated through SBDC counseling. To be conservative, only clients who indicated that the SBDC's services were beneficial were used. The tax revenues generated by long-term clients were compared to the total cost of the Northeastern California SBDC. Established business clients were also asked to estimate jobs and revenues saved due to the counseling services provided by the SBDC.

To gain additional insights into the value of the services offered by the Northeastern California SBDC the financing obtained by clients as a direct result of SBDC assistance was analyzed.

The Northeastern California SBDC counseled 588 long-term clients during 2007. Of these, 361 were established businesses and 227 were pre-ventures. Approximately 86% of the respondents said that the services received were beneficial. In aggregate, the long-term clients of the Northeastern California SBDC experienced a decline in sales of approximately \$33,000. However, 55 new jobs were created because of SBDC counseling assistance (see Table 1). We estimate that an additional \$3.3 million in sales and 520 jobs were saved due to the counseling.

The incremental performance of established business clients resulted in negative tax revenues of approximately \$0.19 million. However, \$0.41 million in tax revenues were gained from pre-venture clients who started new businesses. The total amounted to \$0.22 million in tax revenues, of which approximately \$0.04 million went to the state and 0.17 million, went to the federal government.

Compared to the total cost of operating the SBDC (\$2.63 million), the counseling provided to both established business and pre-venture clients generated \$0.08 in tax revenues in one year for every \$1 spent on the entire program. The average cost of each new job generated was \$47,812.¹

Furthermore, an estimated \$10.4 million in financing was obtained by clients as a result of the counseling received. This figure suggests that every dollar expended on the SBDC operation was leveraged by approximately \$3.97 in new capital raised from external sources.

¹ Revenues retained and jobs saved were not figured into the benefit to cost estimates. Had we done so the overall tax impact estimates would increase to \$2.45 million, a number that is 93% of the entire budget of the SBDC. The cost per job estimate would likewise improve to \$4,573.

TABLE 1
ESTIMATED IMPACT OF SBDC COUNSELING

	Established Firms (N = 361)	Pre-Ventures (N = 227)	All Firms (N = 588)
Aggregate sales impact	-\$678,886	\$ 645,493	-\$ 33,393
Aggregate employment impact	-39 new jobs	94 new jobs	55 new jobs
Existing revenues maintained	\$3,330,586		
Existing jobs saved	520 jobs saved		
<hr/>			
State tax revenues generated	-\$ 68,044	\$111,540	\$ 43,496
Federal tax revenues generated	-\$120,638	\$294,767	\$174,129
Total tax revenues generated	-\$188,682	\$406,307	\$217,625
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Cost of entire SBDC operation			\$2,629,234
Benefit to cost ratio	-0.07/1.00	0.15/1.00	0.08/1.00
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Cost per job			\$47,812
<hr/>			
Cost of all counseling			\$946,668
Benefit to cost ratio	-0.20/1.00	0.43/1.00	0.23/1.00
<hr/>			
Cost of long-term counseling	\$331,334	\$152,414	\$483,748
Benefit to cost ratio	-0.57/1.00	2.67/1.00	0.45/1.00
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SBA financing	\$1,350,075	\$ 234,094	\$ 1,584,169
Debt financing	\$7,915,828	\$ 234,094	\$ 8,149,922
Equity financing	\$ 0	\$ 702,281	\$ 702,281
Total financing	\$9,265,903	\$1,170,469	\$10,436,372
Financing Leverage	3.52/1.00	0.45/1.00	3.97/1.00

INTRODUCTION

This report describes the results of a study designed to assess the economic impact of the long-term counseling activities of the Northeastern California Small Business Development Center (SBDC) program in 2007. Long-term clients are those who received a minimum of five hours of counseling assistance from the SBDC. The economic impact of counseling activities was analyzed by comparing clients' sales and employment changes between 2007 and 2008 with the average changes for all California businesses during this time period. The growth in sales and employment in excess of statewide averages was used to calculate the incremental federal and state tax revenues generated the year after counseling assistance was provided. The tax revenues generated by SBDC-counseled clients were then compared to the cost of the service to determine if it was cost effective.

To supplement this analysis, clients were also asked to estimate the jobs and revenues saved as a consequence of the counseling received. In addition to this, clients were asked to indicate the amount of debt and equity financing they were able to obtain as a direct result of the counseling received from the SBDC.

The remainder of this report describes the methodology and results of the study.

THE STUDY

In 2007 the Northeastern California SBDC provided long-term counseling to 588 clients of whom 361 owned established small businesses and 227 were seeking to start new businesses (pre-ventures). The entire population of long-term clients was sent a mail questionnaire. A total of 82 clients returned usable questionnaires, a 13.9% response rate.² However, since 120 questionnaires were returned undeliverable, the effective response rate was 17.5%.

² Not all of the respondents provided usable responses to every question; therefore, the effective sample sizes for the analyses may vary.

SAMPLE SIZE

To determine if the number of responses received were statistically reliable, the following formula was used:

$$Z = [nNE^2/(Ns^2 - ns^2)]^{1/2}$$

where: n = actual sample size (82).
N = size of population (588).
s = standard deviation of the population (standardized value = 1).
Z = confidence interval for the mean.
E = amount of error in the mean to be tolerated (20% of s).

With a sample size of 82 and a tolerated error of 0.2 of a standard deviation, the confidence interval of the mean was 94.9%. In other words, we were 94.9% confident that our sample means were no more than one-fifth of one standard deviation from the population means.

SAMPLE VALIDATION

Statistical tests were conducted to ensure that there was a minimum likelihood of response bias and that the responses to the questionnaire were reliable. The following procedures were used.

Response Bias. Two mailings of the questionnaire were conducted. T-tests between respondents to the first and second mailings provided no evidence of response bias for established business or pre-venture respondents along the following dimensions: number of employees, sales revenues, financing obtained, or the evaluation of the benefits of the SBDC's services. Since late responders should be more similar to non-respondents than early responders are, we conclude that there is no evidence of an upward bias on the performance data provided by pre-venture respondents.

Reliability. The reliability of the questionnaire was assessed by a correlation analysis comparing clients' perceptions of whether the SBDC's services were beneficial and their evaluations of (1) the quality of their counselors, and (2) their willingness to recommend the SBDC to others. The

results of the correlation analyses were statistically significant at the .01 levels for pre-ventures and established business clients.

DATA ANALYSIS METHODS: ESTABLISHED BUSINESSES

The changes in sales and employment for the period before and after counseling was received were calculated for businesses receiving at least five hours of assistance. Two part-time employees were considered equivalent to one full-time employee.

The rate of growth in sales and employment for established clients was compared with the average growth of all businesses in California.³ The difference between the growth rate of clients' businesses and that of businesses in the state was used to estimate the incremental or marginal changes in the sales and employment of the sample. To be conservative, we chose not to impute impact to clients who did not believe they received value from the SBDC. Thus, only those who indicated that its services were beneficial were used to calculate incremental growth rates.

The incremental growth rates were multiplied by the average sales and employment of the respondents for the year counseling was received. The incremental change in sales was then multiplied by the state sales tax rate. The state sales tax rate was reduced by 25% to reflect the fact that some businesses do not pay sales taxes. This adjustment was arbitrary and may still overestimate taxes paid on sales. However, it compensates for the fact that businesses are taxed in ways not measured in this study (e.g., corporate income tax rates, property taxes, etc.).

The incremental change in employment was multiplied by the median state and federal income taxes paid per return for the state of California. Federal income tax data were obtained from Table 2 of the SOI Bulletin published by the IRS (Spring 2009). Tax data for 2007, the most recent figure available, was

³ Comparative data on sales were obtained from the Bureau of Economic Analysis database. Comparative data on employment were obtained from the Bureau of Labor Statistics.

used. Income taxes paid per return for persons of median incomes were used rather than average income taxes for all returns. This was done to better reflect the types of employment opportunities offered by responding small business owners. This again represents a conservative adjustment to the data.

The Northeastern California SBDC supplied information on state income tax paid per return for 2007, the most recent year available. Since the median federal income tax paid per return was lower than the California average, the average state income tax paid per return was adjusted proportionally.

Adjusted sales tax rates and median state personal income tax payments were multiplied by the average incremental improvement in sales and employment, respectively, to arrive at the state value added figures. Median federal personal income tax paid per return was also multiplied by the average incremental improvement in employment. All these numbers were then multiplied by the total number of established business clients, adjusted for the proportion of the respondents who indicated the SBDC's services were beneficial. The formula for the calculations can be expressed as follows:

$$\begin{array}{l} \text{Average} \\ \text{Incremental} \\ \text{Growth} \end{array} \times \text{Tax Rate} \times \text{Proportion of Clients} \times \text{Total Number} = \text{Total Tax} \\ \text{Satisfied w/Service} \quad \text{of Clients} \quad \text{Revenues}$$

DATA ANALYSIS METHODS: PRE-VENTURE CLIENTS

Similar procedures were used for long-term pre-venture clients, with the following exceptions. First, since pre-ventures start with no sales or employees, it is impossible to calculate a rate of growth. Thus, raw averages were used to assess economic impact. Second, the averages were adjusted to account for the total number of pre-venture clients who failed or did not start a business. This adjustment was made as follows:

$$\text{Average Performance} = AS \times (NS/NP)$$

where: AS = average performance (sales and employment) of successful pre-ventures
NS = number of successful pre-ventures
NP = number of pre-ventures (successful + unsuccessful)

Once this adjustment was made, the sales and employment growth of pre-venture respondents was multiplied by the corresponding tax rates, the proportion of pre-ventures who judged the SBDC's services to be beneficial, and the total estimated number of pre-venture clients. This formula is shown below.

Average X Tax X Proportion of Clients X Total = Total Tax
Performance Rate Satisfied w/Service Clients Revenues

BENEFIT TO COST OF SBDC SERVICES

The benefit of the services provided by the SBDC was divided by the total cost of providing the services to arrive at a benefit-to-cost ratio. The SBDC's total operating budget was used for this calculation. This was a conservative approach since only a part of the SBDC's' budget was spent on counseling assistance. Thus, to obtain further insights we also compared the tax revenues generated by clients with the cost of counseling activities both in total and for long-term established and pre-venture clients separately. The cost of long-term counseling was estimated based on the proportion of total counseling hours devoted to those clients, per data supplied by the SBDC.

OTHER ANALYSES

Quality of Counseling Services. Clients were asked whether the services provided by the SBDC were beneficial. This question was used to determine whether clients' performance improvements were affected by SBDC counseling. As noted above, the performance improvements of responding clients were adjusted to account for the proportion that believed the SBDC's services were beneficial when extrapolating the results to the full population of clients.

Clients were also asked to assess the knowledge and expertise of counselors assigned to their cases as well as their working relationship with the counselors. Clients evaluated their counselor's knowledge/expertise and working relationship on a five-point scale: (1) poor, (2) below average, (3) average, (4) above average, and (5) excellent. These questions provide further

evidence of the quality of the counseling services. In the main, however, these questions were used to assess the reliability of the question concerning whether the SBDC's services were beneficial.

Revenue and Job Retention. Established business clients were asked to estimate the number of full- and part-time jobs that were saved as a result of the assistance received from the SBDC. We also asked clients to estimate the amount of previous sales revenue maintained as a result of SBDC assistance.

Financing. Established business and pre-venture clients were also asked to estimate the amounts of SBA guaranteed loans, other loans, and equity financing obtained directly as a consequence of SBDC counseling activities. To remain conservative, only those clients who indicated that the SBDC assisted them prepare to obtain financing were used for this analysis. Extrapolation to the entire client population was made after adjusting for the proportion of clients who indicated the SBDC assisted them raise capital.

RESULTS

The results of the analysis of the counseling services provided by the Northeastern California SBDC to established business and pre-venture clients are presented below.

ESTABLISHED BUSINESSES

Quality of Counseling. Of those who provided usable responses to the service evaluation question, 89% indicated that the SBDC's services were beneficial. Furthermore, clients gave a rating of 4.25 out of a possible 5.00 on the knowledge and expertise of their counselors and a rating of 4.20 on their working relationship with the counselors (scores of 3 indicated an average rating, scores of 4 indicated an above average rating, and scores of 5 indicated an excellent rating). Finally, 91% of the responding established business clients indicated that they would recommend the SBDC's services to others.

Economic Impact Estimates. Table 2 compares the 2007 and 2008 sales and employment levels of established small business clients. Table 3 compares the SBDC clients' growth in sales and employment between 2007 and 2008 with the growth experienced by the average business in California. As these Tables show, SBDC clients had an average increase in sales of \$854. In percentage terms the SBDC clients increased sales was smaller than that of the average business in California (0.7% versus 2.5%). There was also a decrease in the number of individuals employed by clients in 2008 compared to 2007 (2.76 versus 2.89). Employment levels of established clients decreased by 4.5% compared to a 0.3% decrease in employment for California businesses in general.

The overall impact estimate for established business clients suggests that the SBDC's services led to a tax loss of approximately \$0.19 million. This broke down as a loss of approximately \$0.07 million to the state government and a loss of \$0.12 million to the federal government (See Table 4).

As shown in Table 5, comparatively, these tax revenues were -8% of the SBDC's total operating budget, -20% of its counseling budget, and -57% of the amount spent on long-term established clients.

Revenue and Job Retention. To supplement the impact estimates we also asked established clients if the SBDC helped them save jobs and retain existing revenues. On average, clients estimated that the SBDC program was responsible for saving \$9,226 in revenues and 1.44 full-time equivalent jobs. In total, this amounted to \$3.3 million in revenues retained and 520 jobs saved.⁴

Financing Obtained. According to the respondents, 14% of established business clients were assisted in preparing to seek financing. Those clients obtained an average of \$183,338 in capital, of which \$26,713 came from SBA loans, \$156,625 came from other forms of debt financing, and \$0 came from

⁴ It should be noted again that revenues retained and jobs saved were not figured into the benefit to cost estimates. Had they been included the benefit to cost estimates would be higher.

equity financing. Extrapolations indicate that clients raised \$1.35 million in SBA loans, \$7.92 in other debt financing, and \$0 in equity financing (\$9.27 million in total) with the help of the SBDC. This suggests that the total expenditure of tax dollars on the SBDC were leveraged by public and private financing at a ratio of 3.52 to 1.00 for long-term established business clients alone.

Our estimates suggest that of 361 established business clients, 32 received SBA loans and 25 received loans from other sources as a consequence of SBDC long-term counseling. However, none of the clients received equity financing through SBDC assistance.

PRE-VENTURE CLIENTS

Perceptions of the Quality of Counseling. Of the pre-venture clients who provided an evaluation of the SBDC's services, 83% felt the counseling was beneficial. In addition, clients gave a rating of 3.58 out of a possible 5.00 on their counselors' knowledge and expertise, and a rating of 3.44 on their working relationship with the counselors (scores of 3 indicated an average rating, scores of 4 indicated an above average rating, and scores of 5 indicated an excellent rating). Moreover, 95% of the responding pre-venture clients indicated that they would recommend the SBDC's services to other entrepreneurs.

Economic Impact Estimates. After adjusting for unsuccessful clients, we calculated that an average of \$3,426 in sales and 0.50 new jobs were created per pre-venture client. As Table 6 shows, these new ventures generated tax payments of approximately \$0.4 million (\$0.1 million to the state and \$0.3 million to the federal government).

When compared to the cost of the entire SBDC operation, the tax revenues from pre-venture clients generated \$0.15 for every dollar expended. Furthermore, the tax revenues generated were 43% the cost of the SBDC's counseling activities. Finally, the tax revenues from pre-venture clients

exceeded the amount expended on pre-venture who received long-term counseling by a ratio of 2.67 to 1.00 (see Table 7).⁵

Financing Obtained. According to the responses, 33% of all pre-venture clients received assistance from the SBDC in preparing to obtain financing. The average raised was \$3,125 in SBA loans, \$3,125 in other sources of debt financing, and \$9,375 in equity financing for a total of \$15,625. Extrapolating to the population suggests that a total of \$0.23 million in financing from SBA loans, \$0.23 million from other sources of debt, and \$0.70 million in financing from equity investors were raised. The grand total of approximately \$1.17 million in financing suggests that each tax dollar expended on the SBDC was leveraged by \$0.45 in public and private financing for new ventures.

Our estimates also suggest that of 227 pre-venture clients 9 received SBA loans as a consequence of SBDC long-term counseling. Furthermore, 9 clients received other loans, and 19 received equity financing.

SUMMARY AND CONCLUSIONS

Results of this study suggest that the Northeastern California SBDC makes a contribution to the economic development of the State of California. Although our analysis indicated that SBDC clients lost approximately \$33,000 in incremental sales, they added 55 new jobs to the state. The latter number suggests that the cost of generating a new job through investment in the Northeastern California SBDC was \$47,812 per job. Furthermore, an additional \$3.3 million in sales and 520 jobs were saved because of the SBDC's interventions.⁶

Estimates suggest that the one-year tax benefits accruing as a consequence of the performance improvements of SBDC-counseled clients generated

⁵ Pre-ventures had no sales or employees at the time the counseling was received. Therefore, we did not attempt to measure revenue or job retention.

⁶ If we counted the number of jobs saved (520) and created (55), the cost per job would be \$4,573.

a return of \$0.08 for every dollar spent on the entire SBDC operation in Northeastern California. When compared to the cost of long-term counseling our estimates indicate that \$0.45 was returned for each dollar expended on counseling.⁷

Finally, we estimate that \$10.4 million in capital was raised by clients as a direct result of the assistance of the SBDC. This suggests that each dollar expended on the Northeastern California SBDC program was later leveraged by approximately \$3.97 in debt and equity capital.

The numbers presented in this report are only estimates based on responses to a questionnaire. It is possible that the respondents were not representative of the population of clients, factors such as social desirability bias may have inflated the estimates, or SBDC clients are especially prone to exceed sales and employment growth rates of "average" businesses in the state. It is also possible that some of the gains of the clients were not net gains to the economy.

While impact methodologies are always susceptible to such problems the tests conducted for bias and reliability suggest that the results are a reasonably accurate representation of the performance of the California SBDC's counseling for long term clients. Furthermore, the results must be viewed in light of the fact that they are net of all the conservative downward adjustments in performance described earlier in this report. Thus, the estimates reported herein do not consider the impact of other SBDC services, the continuing tax revenues generated by long-term clients after the year of analysis, the many failures avoided through SBDC assistance, the unviable business ideas it discouraged, nor the jobs and revenues saved. Other tax

⁷ Revenues retained and jobs saved were not figured into the benefit to cost estimates. Had we done so the overall tax impact estimates would increase to \$2.45 million, a number that is 93% of the entire budget of the SBDC and 5.06 times greater than the cost of long-term counseling activities.

revenue sources such as corporate taxes, property taxes, unemployment taxes, social security payments, and so on are also not included in the analysis.

From a public policy standpoint, the implication of this research is that the SBDC makes a contribution to the economies of California and U.S. By assisting established small businesses improve their operations and raise capital the Northeastern California SBDC contributes to the more efficient allocation and utilization of resources. Furthermore, these small firms provide employment opportunities for the citizens of California; the SBDC also helps preserve these opportunities in firms facing turnaround situations. The SBDC also plays an important role in fostering entrepreneurship through the assistance it provides to pre-venture clients. Those clients add to the economic development of California and the United States and, not incidentally, generate new jobs. Because the SBDC provides assistance to small business people and would-be entrepreneurs who often cannot afford the luxury and expense of a private consultant, its contributions become even more important. The evidence that its assistance generates enough tax revenues to state and federal governments, and value and capital to its clients to provide a fair one-year return on the direct cost of providing the services makes the existence of the Northeastern California SBDC program justifiable from a public policy perspective.

TABLE 2
2007-2008 AVERAGE EMPLOYMENT OF ESTABLISHED CLIENTS
WHO INDICATED THAT SBDC ASSISTANCE WAS VALUABLE

	2007	2008	Change
Sales	\$117,415	\$118,269	+\$ 854
Employment	2.89	2.76	- 0.13

TABLE 3
CHANGES IN EMPLOYMENT BETWEEN 2007-2008: SBDC ESTABLISHED
BUSINESS CLIENTS VERSUS AVERAGE STATE BUSINESS

	Average % change in small business sample	Average % change all firms in state	Average incremental change in small business sample	
			percent	aggregate
Sales	+ 0.7%	+ 2.5%	- 1.8%	-\$2,113
Employment	- 4.5%	- 0.3%	- 4.2%	-0.12 jobs

TABLE 4
INCREMENTAL TAX REVENUES ADDED TO STATE AND FEDERAL GOVERNMENTS
AS A RESULT OF SBDC COUNSELING OF ESTABLISHED BUSINESS CLIENTS

STATE TAX REVENUES

	Tax	X	Tax	X	% Clients	X	# of Long	=	Total Tax
	Base		Rate		Valuing		Term Clients		Revenues
					Service				Generated
Sales	-2,113		.054*		.89		361		-\$ 36,660
Employment	-0.12		\$814**		.89		361		<u>-\$ 31,384</u>
									-\$ 68,044

FEDERAL TAX REVENUES

Employment	-0.12		\$3129***		.89		361		<u>-\$120,638</u>
TOTAL INCREMENTAL STATE AND FEDERAL TAX REVENUES									-\$188,682

* Figure represents 75% of state sales tax rate (7.25%) in 2008.

** Figure represents average state income tax paid per return by persons of median incomes in 2007.

*** Figure represents average federal income tax paid per return by persons of median incomes in California in 2007.

TABLE 5
THE COSTS AND BENEFITS OF SBDC COUNSELING: ESTABLISHED BUSINESSES

Total incremental State and Federal Tax Revenues Added by Established Business Clients	-\$188,682
Cost of operating the SBDC	\$2,629,634
Benefit to cost ratio	-0.07/1.00
Cost of all counseling *	\$946,668
Benefit to cost ratio	-0.20/1.00
Cost of long-term counseling provided to established business clients **	\$331,334
Benefit to cost ratio	-0.57/1.00

* Approximately 36% of the total SBDC budget was used for counseling long and short term clients.

** Established business clients who received long-term counseling accounted for approximately 35% of the total counseling budget.

TABLE 6
INCREMENTAL TAX REVENUES ADDED TO STATE AND FEDERAL
GOVERNMENTS AS A RESULT OF SBDC COUNSELING OF PRE-VENTURE CLIENTS

STATE TAX REVENUES

	Tax	X	Tax	X	% Clients	X	# of Long	=	Total Tax
	Base		Rate		Valuing		Term Clients		Revenues
					Service				Generated
Sales	3,426		.054*		.83		227		\$ 34,857
Employment	0.50		\$814**		.83		227		<u>\$ 76,683</u>
									\$111,540

FEDERAL TAX REVENUES

Employment	0.50		\$3129***		.83		227		<u>\$294,767</u>
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TOTAL INCREMENTAL STATE AND FEDERAL TAX REVENUES \$406,307

* Figure represents 75% of state sales tax rate (7.25%) in 2008.

** Figure represents average state income tax paid per return by persons of median incomes in 2007.

*** Figure represents average federal income tax paid per return by persons of median incomes in California in 2007.

TABLE 7
THE COSTS AND BENEFITS OF SBDC COUNSELING: PRE-VENTURES

Total incremental State and Federal Tax Revenues Added by Pre-Venture Clients	\$406,307
Cost of operating the SBDC	\$2,629,634
Benefit to cost ratio	0.15/1.00
Cost of all counseling *	\$946,668
Benefit to cost ratio	0.43/1.00
Cost of long-term counseling provided to pre-venture clients **	\$152,414
Benefit to cost ratio	2.67/1.00

* Approximately 36% of the total SBDC budget was used for counseling long and short term clients.

** Pre-venture clients who received long-term counseling accounted for approximately 16.1% of the total counseling budget.