

HOW SMALL BUSINESSES CONTRIBUTE TO U.S. ECONOMIC EXPANSION

Derek Leebaert

Small businesses contribute much more to the U.S. economy and society as a whole than can be calculated just from the spending and profit that they generate. These businesses tend to be more economically innovative than larger companies, more able to respond to changing consumer demand, and more receptive to creating opportunities for women and minorities, and activities in distressed areas. "Building, running, and growing small business is a part of a virtuous cycle of creativity and increasing prosperity that can be applied by dedicated and thoughtful people anywhere," the author says. "There are no secrets, and frequently money is less important than a considered combination of imagination and effort."

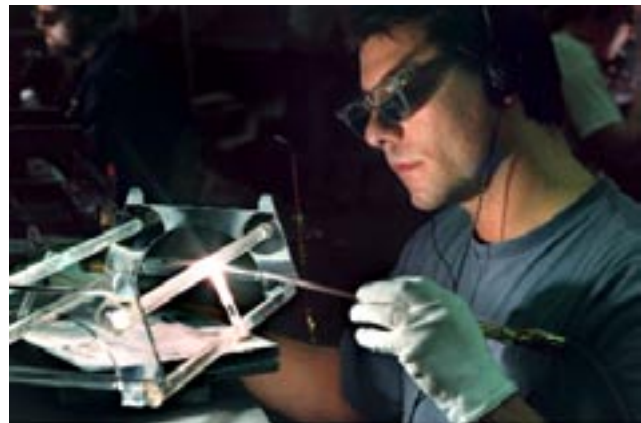
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A visitor to the United States will encounter many newspapers and magazines devoted to business: *The Wall Street Journal*, *Fortune*, *Forbes*, *Business Week*, *Barron's*. On television and radio, he or she will hear about the Dow Jones Industrials and the S&P 1000—statistics that reflect the stock market's highs and lows, as shown by the value of the largest U.S. companies. The very term Fortune 500, coined 50 years ago by *Fortune* magazine, ranks the leading companies in the nation: General Motors, General Electric, DuPont, and, more recently, Microsoft and Oracle. Moreover, brand names such as Ford, Coca Cola, and IBM likely have been commonplace in his or her own country for decades. Against this background, our visitor might get the impression that America's economy, employment, innovation, and exports are propelled solely by such behemoths.

Many Americans share that impression, and it is wrong. To be sure, the largest 500 or 1,000 corporations offer exciting material for journalists, as shown by the chronicling of boardroom scandals and corporate takeovers. These enterprises are visible, politically influential, and—because of their size and relative stability—the repositories of pension fund and other long-term investment for many Americans. They make up much of the nation's total output of goods and services. But to understand the full scope of national output, as well as of job creation and innovation in the U.S. economy, let alone where those huge corporations originated, we have to look beyond the headlines.

FUELING AMERICA'S GROWTH

Small and large businesses are not distinct segments of the U.S. economy: They buy each other's products and build on each other's innovations to generate economic growth. The smaller businesses are frequently younger ones created by self-employed entrepreneurs. Such activity contributes further to economic growth by challenging traditional technologies and practices. In turn, economic growth promotes entrepreneurial activity by providing markets and financing for men and women bold enough to venture alone into the stormy seas of a consistently expanding economy.



An employee of MGI Products Inc. welding a portion of a quartz wafer carrier; a device for holding a wafer for processing in semiconductor manufacturing.

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Because of this widespread drive to start and build businesses, the United States benefits more from such a growth cycle than do other industrial economies. To varying degrees, entrepreneurship is apparent in every American neighborhood, and it is by no means limited to the high technology that is often chronicled by the press. Nor must a small business necessarily be a new one—but to sustain it requires the agility of an entrepreneur merely to avoid falling prey to the advantages of cash, reach, and buying power enjoyed by big corporations.

A small business is not defined solely by revenue or number of employees, let alone by how long it has been open, but by its function in the economy. For example, a “small” manufacturing company is one with fewer than 500 employees, whereas a “small” wholesale trading company may have no more than 100 employees. Because of the different costs to the owner of his or her materials, a carpet cleaning business, for instance, is considered “small” if its annual revenue is less than \$4 million, while a “small” construction company can have revenue as sizable as \$30 million. Such precision is required by statisticians in order to align these businesses with government programs designed to provide loans, training, and tax relief to these sources of growth.

Indeed, there are “micro-businesses” that have annual revenues under \$1 million—relatively insignificant in the business world, one might think, until we consider that such microenterprises represent as much as 15 percent of the U.S. economy. At the other extreme of our definition, we can find those “small manufacturers” with up to 500 workers, though most are still family-owned—and include about 330,000 separate companies employing roughly 7 million workers.

From a two-person software start-up to a fleet of trucks helping to build cities, the small-business sector catalyzes economic expansion by:

- making up 99.7 percent of all U.S. employers, meaning that only 17,000 companies, or 0.3 percent of all employers, have 500 or more employees;
- generating half the nonfarm output of the U.S. economy, and employing about half of all Americans not working for government, while adding 60 to 80 percent of net new (nongovernmental) jobs annually;
- comprising 97 percent of exporters and producing 29 percent of all export value—key points when we consider that exports have accounted for about 25 percent of U.S. economic growth over the past decade and support an estimated 12 million jobs;
- winning nearly 24 percent of all government



Steve Jobs, founder of Apple Computer, displaying images of iMac computers at a convention.

AP/Wide World Photo

contracts, ranging from ship construction to printing brochures.

Small businesses are often the beginnings of large ones, as we are reminded by the 30th anniversary of Apple Computer, which was founded in 1976 by three members of the Homebrew Computer Club. Yet not all of America’s 23 million small businesses aspire to the Fortune 500. There are companies—such as the brewer Anchor Steam—that realize that profits can come from resisting the temptation to expand. Their contribution to the economy is to offer niche products and services not offered by big corporations—and often to charge more for such specialization. It is the diversity as well as the dynamism of an economy that assures a continually upward path.

SHAPING INNOVATION AND FLEXIBILITY

Small businesses provide catalytic benefits to the economy. They contribute to national output, and to the society as a whole, beyond the spending and profit they generate. Consider the following.

In terms of economic innovation:

- small businesses produce 13 to 14 times more patents per employee than do large firms;
- small businesses’ patents are twice as likely as those from the larger firms to be among the 1 percent most cited (that is, the most significant);
- small businesses employ 39 percent of high-tech workers such as scientists, engineers, and information technology workers, generating the majority of innovations that come from U.S. companies;
- these businesses are able to pioneer new alliances

and partnerships, in contrast to large businesses with demarcated competitive interests, as shown by biotechnology companies vis-à-vis the U.S. pharmaceutical giants.

In terms of economic flexibility:

- high spending on information technology enables agile responses to changing customer requirements: small and mid-sized firms account for 45 percent of U.S. technology spending;
- firms of 100 to 1,000 workers are spending eight times faster on technology than are big corporations, further enabling the close touch of business owners with the end users of their products or services;
- by deploying flexible production techniques enabled by both technologies and newly efficient practices, small businesses can adapt faster to shifting economic conditions;
- small businesses act as a shock absorber for fluctuations in employment caused by downsizing and globalization: 53 percent of small businesses operate out of an individual's home, from hair styling for neighbors to consulting for other businesses large and small.

In terms of social cohesion:

- small businesses serve as an entry point into the economy for new or previously slighted workers: women-owned small businesses, for instance, generate nearly a trillion dollars in revenues annually and employ more than 7 million workers;
- small businesses increasingly generate entrepreneurial opportunities for minorities, which census data show as owning 4.1 million firms that generate \$695 billion annually and employ 4.8 million workers;
- small businesses bring economic activity to distressed areas: about 800,000 companies (90 percent of them microenterprises) are located in the poorest areas of the 100 largest U.S. cities;
- small businesses offer job satisfaction and autonomy: studies show that most businesses are started to improve one's condition, rather than for lack of an alternative, with some half a million new businesses started each month.

"A VIRTUOUS CYCLE"

The small-business sector constitutes a large part of the U.S. economy, but its influence transcends its already significant size. As economies prosper more from



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A freelance writer working at his home.

how they apply knowledge rather than materials, there is an ever-greater premium on innovation, flexibility, large-scale customization, and specialization—whether in serving sandwiches or programming software. While the percentage of Americans employed by Fortune 500 companies steadily drops (from 20 percent of the workforce in 1980 to less than 9 percent today), an average of 9.36 percent of the population could be found over the last decade starting their own businesses.

There are successes—two-thirds of new businesses with more than a single employee are still open after two years—and honest failures, which bring no social stigma in the United States. One can try again, perhaps with a more refined innovation, a better understanding of the market, and new entrepreneurial allies. Building, running, and growing small business is part of a virtuous cycle of creativity and increasing prosperity that can be applied by dedicated and thoughtful people anywhere. There are no secrets, and frequently money is less important than a considered combination of imagination and effort. ■

The opinions expressed in this article do not necessarily reflect the views or policies of the U.S. government.