SMALL BUSINESS IN U.S. HISTORY

Christopher Conte

Americans have long revered small businesses for not only building the economy but also bolstering democracy. For more than a century, the United States has implemented laws aimed at preventing big business from competing unfairly with small businesses. Whether small businesses create a disproportionate number of jobs is not clear, but they clearly have influenced big businesses, which have adopted the flexible practices of smaller companies.

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Calvin Coolidge, the president of the United States during the "roaring" 1920s, famously declared that "the business of America is business." For the first century of the country's existence—until the 1880s—it would have been equally accurate to say that the business of America was *small* business since virtually all businesses in the nation were small in those years. Large-scale enterprises have eclipsed small business to a significant degree since then, of course, but the vast majority—almost 90 percent of American employers have fewer than 20 workers—are still small. Moreover, small businesses continue to have a strong hold on the American imagination.

Businesses had no choice but to be small in America's early days. Transportation was slow and inefficient, keeping markets too fragmented to support large-scale enterprise. Financial institutions also were too small to support big business. And productive capacity was limited because wind, water, and animal power were the only sources of energy. Whatever the reason businesses were small, Americans liked it that way. Small business, they believed, cultivates character and strengthens democracy. As Thomas Jefferson, the third president of the United States, put it, a nation of farmers and small businesspeople would avoid dependence, which "begets subservience and venality, suffocates the germ of virtue, and prepares fit tools for the designs of ambition."

The American belief in small business was put to the test beginning in the late 1800s. Railroads, the telegraph, the development of steam engines, and rapid population growth all created conditions in which some businesses —especially capital-intensive ones such as primary metals, food processing, machinery-making, and chemicals— could become bigger and, in the process, more efficient. Many people celebrated the higher wages and lower prices that came with large-scale enterprise, but others worried that the qualities Jefferson extolled might be lost in the process. "Even as they embraced what they viewed as the superior efficiency and productivity of big business," wrote historian Mansel Blackford in *A History of Small Business in America,* "Americans continued to revere small businesspeople for their self-reliance and independence."

AP/Wide World Photo

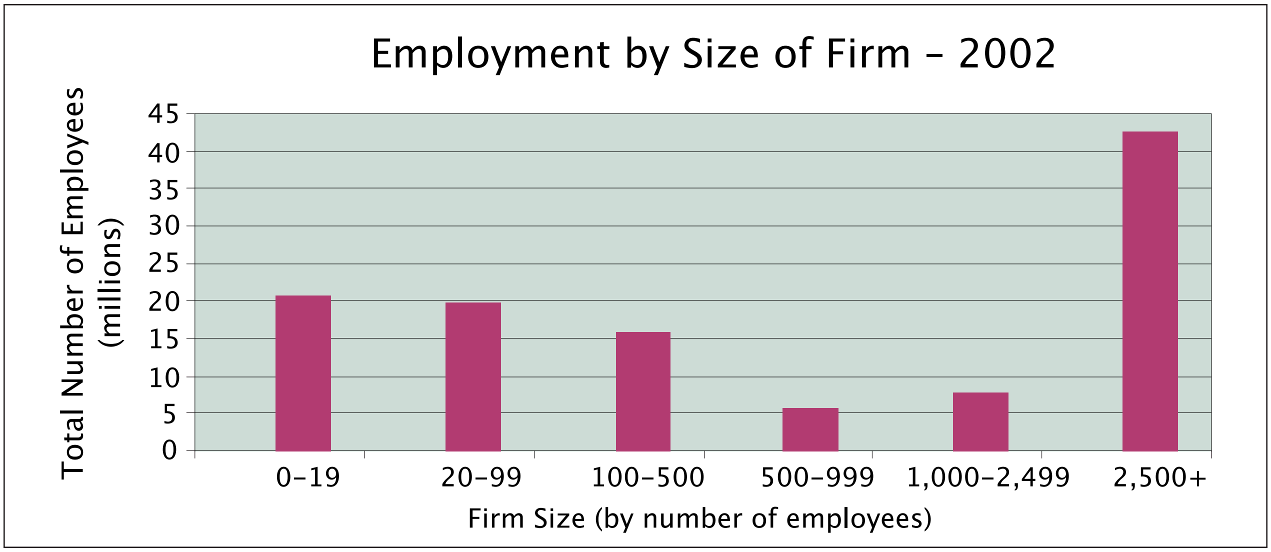
In the early 1900s, employees at the retail chain store Woolworth, which grew from a single store opened in 1879.

LEGISLATION VS. ECONOMIC REALITY

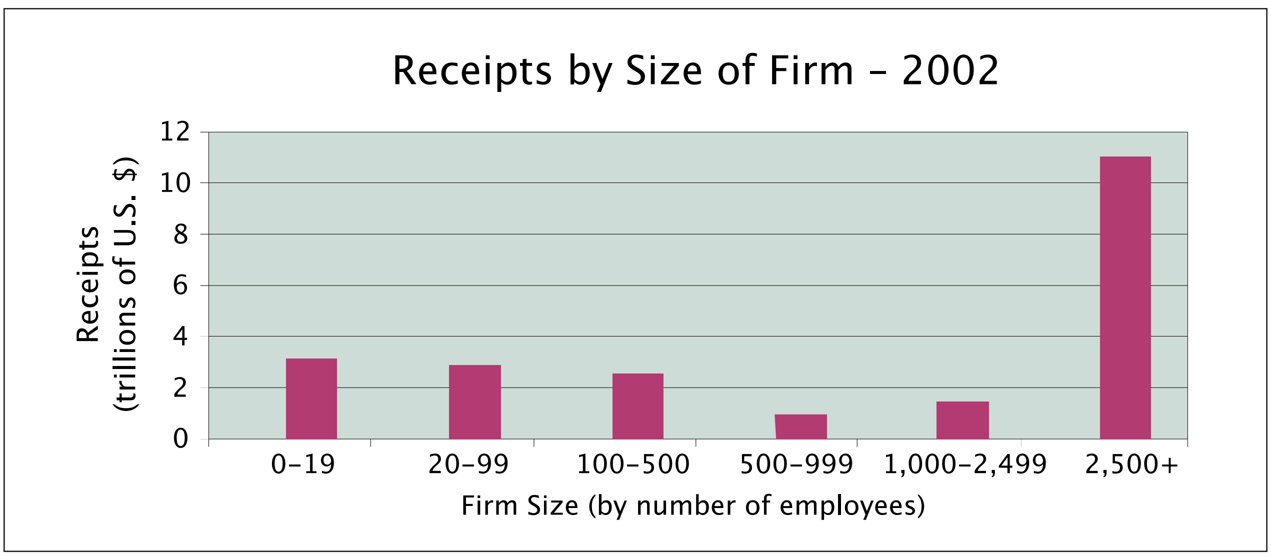
As Blackford describes, policy-makers have sought repeatedly to reconcile Americans' appreciation for the benefits that big business brings them with their reverence for the small businessperson. In 1887, the U.S. Congress enacted the Interstate Commerce Act to regulate railroads, partly to protect smaller businesses from what was deemed a natural monopoly. Then, the Sherman Antitrust Act (1890) and the Clayton Antitrust Act (1914) sought to prevent big companies from exercising

WHERE DO AMERICANS WORK?

Most businesses in America are small. In 2002, 88 percent of the nation's 5.7 million businesses employed fewer than 20 people, and 99.7 percent employed fewer than 500 people. But almost half of all Americans work for companies that employ more than 500 people, and two-thirds work for companies that employ more than 100 people, as the chart below demonstrates.



Big companies also account for a larger share of the nation's output than gross figures on the number of firms suggest. The chart below shows that although small firms outnumber large ones, the largest ones—those with more than 2,500 employees—collect 50 percent of all receipts.



Source: U.S. Small Business Administration, Office of Advocacy excessive power in the marketplace. Later, the Robinson-Patman Act of 1936 and the Miller-Tydings Act of 1937 aimed to rein in large chain-store retailers.

In each of these laws, however, small-business enthusiasts had to mollify legislators who opposed government interference in the economy and saw big business as more efficient than small business. The result was a series of compromises that limited the ability of big businesses to use their power to stifle competition at least somewhat, but did not prevent them from growing big through methods deemed fair. The Sherman Act, for instance, did not crack down on bigness per se, and in fact often was used to prevent collusion among small businesses as well as big ones. Similarly, the Clayton Act did not outlaw bigness itself, but merely prohibited "unfair" methods of competition.

In 1953, lawmakers took a different approach: They established the Small Business Administration (SBA), a federal agency that provides training and helps small enterprises secure financing, land contracts with government agencies, and raise equity capital. The SBA's actual impact is difficult to gauge. But economists believe small business has survived over the years more as a result of economic realities—and its own ingenuity—than as a result of legislation. In some industries—furniture-making, lumber milling, and many service businesses, for instance—small businesses continued to play an important role because the kind of economies of scale that allowed businesses to grow big in other sectors were largely absent.

In some sectors, small businesses found market niches where there was too little demand to require large-scale production. Blackford cites Buckeye Steel Castings Company of Columbus, Ohio, which was formed in 1881 and thrived for many years by producing automatic railroad car couplers, for instance. He also describes how a variety of small, Philadelphia-based textile companies survived into the 20th century by producing for the constantly fluctuating seasonal-clothing market. More recently, a number of information technology companies have emerged to produce software for highly specific computer applications, and numerous small Internet companies sell products aimed at narrow market segments.

Some businesses have stayed small simply because their owners don't want them to grow bigger. And economists have noted one other role of small businesses: In economic downturns such as the Great Depression of the 1930s and the recessions of 1973-1975 and 1980-1982, many people who lost their jobs in larger companies formed their own small businesses to stay afloat through the hard times.

David Paul Morris/Getty Images

The Palo Alto, California, garage where electronics giant Hewlett-Packard started in 1939.

Overall, while the dream of running one's own business has fueled a steady rise in the number of small businesses in America, the general trend since the 1880s has been for small businesses to grow in number along with the population, but for their relative share of economic output to decline as large corporations have emerged in various sectors. The SBA itself has tacitly acknowledged the trend toward largeness by redefining small business upward. In the 1950s, the agency counted any manufacturer employing fewer than 250 people as small, but today it considers companies with as many as 500 employees to be small. Still, the vast majority of American businesses are small. In 2002, for instance, there were only 16,845 companies employing more than 500 people, compared to 5,680,914 employing fewer people, according to the SBA.

The Significance of Size

Small business demonstrated its durability during the 1970s and 1980s in particular. At the time, foreign competition led to a decline of basic, large-scale manufacturing companies in such industries as steel, automobiles, and textiles. In the new global economy, services became relatively more important while manufacturing became less important, and that meant a growing role for small companies, which traditionally have dominated many service sectors. But some economists saw additional reasons why small business would become a more important part of the economic landscape. In the highly competitive and rapidly changing global economy, they argued, companies that could innovate, customize products, and adapt quickly

AP/Wide World Photo

A repairman from consumer electronics chain store Best Buy making a housecall to set up a computer.

to changing circumstances would have an edge. Small business, with less hierarchical management systems and less unionized workforces, seemed to have just these strengths. What is more, small businesses got an extra boost because declining transportation costs and the emergence of the Internet made it easier than ever for them to compete on the global stage.

The surge in enthusiasm about small business peaked in 1987, when David Birch, an economist and founder of the research firm Cognetics Inc., wrote that small businesses create most of the new jobs in the economy. Birch's findings attracted enormous attention and are still cited to this day. But many economists dispute them. In a 1993 study, for instance, the National Bureau of Economic Research found that while firms employing fewer than 500 people really did create more jobs between 1972 and 1988, they also went out of business far more often. Their net impact on job creation was thus no greater than that of larger firms, the private, nonpartisan research organization concluded.

In any event, small business may have held its own in recent years, but it has not regained the market share it lost to big business over the previous century. In part, that's because big businesses have become more competitive themselves by learning some lessons from their smaller competitors, according to *The Economist* magazine. In 1995, the British publication reported that big businesses increasingly are behaving like small ones, "pushing decision-making down through management ranks, restructuring themselves around teams and product-based units, and becoming more entrepreneurial."

Today, large and small enterprises appear to have reached some kind of equipoise. The small business share of the U.S. gross domestic product, for instance, which was 57 percent in 1958, has hovered at around 50 percent since 1980. If Calvin Coolidge were still alive, he might view such figures and stand by his belief that the business of America is business. But he might add that business in America comes in all sizes, large to small. ■

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