

Testimony of  
William C. McDowell, Ph.D.  
Management Professor of Entrepreneurship and Family Business at East Carolina University  
Vice President of the National Small Business Institute®, and  
Co-Editor of the Small Business Institute® Journal  
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*Large and Small Businesses: How Partnerships Can Promote Job Growth*

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Good afternoon, Chairman Graves, Ranking Member Velázquez, and members of the committee. Thank you for the opportunity to appear before you today to discuss this very important topic. My name is William McDowell, and I am an Entrepreneurship and Family Business professor in the College of Business at East Carolina University as well as the Vice President for Research and Publications for the national Small Business Institute® and co-editor of the Small Business Institute® Journal. The views and research that I will present today are my own and not necessarily those of East Carolina University or the Small Business Institute®.

My research specialty is focused in the area of small and medium sized enterprises (SME) and the relationships between SMEs and large businesses within the supply chain, and I am pleased to be here today to discuss the current challenges and issues facing small businesses, particularly SMEs when interacting with larger businesses. I would like to summarize four key areas in which small businesses face hurdles in interaction with their larger business counterparts as well as obstacles that these small businesses face that are not as prevalent in larger businesses. These include:

1. Access to capital compared to larger businesses;
2. Deep levels of dependency on larger organizations in the supply chain;
3. Tax disadvantages;
4. Access to qualified business experts for advice and direction.

**Access to Capital Compared to Larger Businesses**

Businesses are considered a small business by the SBA based on the number of employees and average annual receipts. Because of the very nature of being small, these businesses generally have fewer assets which can be utilized as collateral when seeking funds for operations, equipment, and expansion. In addition, the relatively smaller product and market scope of these organizations compared to larger organizations often translate into fewer revenue streams, and, due to the economic problems that have become a reality over the past several years, many small businesses depleted cash reserves as well as inventories.

These issues and more have created an environment in which small businesses have more difficulty in accessing necessary capital in comparison to larger businesses. One area where this continues to be especially true is for women, minority and socially disadvantaged businesses. While this has seen improvement over the past two years, it can still be a problem. One of the greatest areas of concern is that, despite the continued push for access and availability, it is often the ignorance of availability that restricts access to capital. For smaller businesses with fewer resources, the time costs involved in researching capital availability and the lack of direction when looking for this capital is of primary concern.

### **Deep Levels of Dependency on Larger Organizations in the Supply Chain**

Research indicates that small businesses are commonly the dependent party when examining the power/dependency levels within interorganizational relationships in the supply chain. These smaller organizations are often niche suppliers to larger organizations, and many times they supply to a single buyer. My own research has demonstrated that increased niche focus actually works against the small businesses ability to land and retain contracts with large suppliers like the federal government.

Unfortunately, these smaller firms can find that their products or services are no longer needed should the larger organization shift their needs or find another, potentially cheaper, source. In addition, smaller firms, in an effort to work with the larger organization, spend considerable resources in aligning activities in the areas of data, inventory, and accounting systems. Once the smaller firm has committed to these changes, the larger organization may begin to squeeze margins beyond the operating point for the smaller business, thus causing the business to look for other buyers or to even close its doors.

Previous research has shown that the performance of smaller organizations is often dependent on the continued exchange of quality information and communication between the larger and smaller organizations. If these smaller organizations have a more trusting relationship with the larger firm in the interorganizational relationship, the firm's confidence and performance will improve. These smaller firms must work towards increasing flexibility and adjust their internal processes in order to continue high performance.

### **Tax Disadvantages**

When examining the tax disadvantages of small firms compared to large firms, it is important to note that it is not necessarily the tax rates that are burdensome, but the ability of small businesses to calculate their own tax liability that is the problem. Larger organizations can easily afford financial experts that assist in determining what can be declared as tax exempt or to find all of the applicable tax credits based on their market or business. Unfortunately, small businesses are at a disadvantage in this area due to not having these qualified experts on staff. These smaller businesses often do not realize the tax savings that they can realize because they are not aware of the tax credits offered to them, and they may feel that the financial burden of obtaining the services of experts in this area are not appropriate with the uncertainty of the

outcome. The reality is that in many instances small businesses have tax credits that they are overlooking or are just not aware of.

While recent data from the National Federation of Independent Businesses (NFIB) indicates that the number one problem for small business has been sales since 2008 (22%), this has come down to almost even with taxes as the number one problem (21%). When these trend lines are examined back to the mid 1980's, however, the dominant area noted as the most important problem for small businesses is taxes with around 20% of firms. This is a solid indication that taxes have been and continue to be a major area of concern for small business. What is interesting is that over the past 25 years, when the tax rates have been up or when they have been down, about one in five businesses state that taxes are their number one problem.

### **Access to Qualified Business Experts for Advice and Direction**

As mentioned earlier, larger businesses have the ability to afford experts in many areas of their business to streamline processes and maximize returns. Small businesses and those individuals who operate or own them often believe that they cannot afford these experts, and many are not even aware of what continuous quality improvement programs and systems can do to their bottom line. Recent research indicates that businesses that are very small don't even consider these systems as beneficial to their business. In many cases, small businesses may not be aware of SBA programs, SBIR programs, programs designed to target disadvantaged businesses, or other government assistance. Again, because of doing it "on their own," these business operators may be missing out on much help.

Small businesses often develop a very narrow focus in business interactions. By not being able to view the total business operations from a wider perspective, they may continue a course with a very narrow scope concerning their own suppliers, buyers, products and markets. Unfortunately dealing with the crises of today often prevents them from thinking about positioning for tomorrow. Again, help in operations, marketing, finances, and other areas may be lacking because of ignorance of availability.

Another potential problem for small businesses is that smaller firms tend to overestimate their expected sales. This is a trend that has been maintained for many years. The reason for this is that small businesses seem to always be overly optimistic about their projected sales, only to be disappointed by the actual sales numbers. This is a distinct disadvantage for smaller firms because many larger firms have experts on hand that can help them to better estimate what their sales are going to be. These larger firms have shareholders and other stakeholders holding them accountable to ensure that these forecasts are very near to correct, whereas the smaller firms may not. A natural result of this would be to continually see sales as a primary problem, when really it is the lack of experts or expertise that results in accurate projections.

### **Recommendations**

While there are many areas where small businesses are at a strategic disadvantage compared to large businesses, these are four of the most pressing areas of concern. When examining each of these areas, the underlying issue in many ways a lack of information. Access to capital is a major hurdle for small businesses, but there are solutions. Continuing the creation of a lending climate favorable to small businesses is a start. Even helping small businesses find access to other opportunities and revenue streams can assist in the ability to secure the necessary financing from operations, development or growth.

Small business dependency issues will continue to be a problem simply because of their size, but better information, a broader scope in market and product, and even more finances to expand and develop can help in this area of weakness. While tax issues are of concern, more information and education concerning tax credits and even more tax advantageous ownership forms can be of help. Again, in each of these areas, the primary help comes through better information.

So, a solution to the fourth issue addressed can also be a solution to all of these areas of concern. Simply put, this comes through helping small businesses have access to qualified experts. Already the SBA offers help and assistance to small businesses to better organize and operate. Local SBDCs, SBCs, and other organizations such as SCORE assist small businesses in business planning and development.

I am personally involved in the Small Business Institute® (SBI) which was developed by the SBA in 1975 (then called the Small Business Institute Directors Association) with the goal of creating collaboration between teams of business students in universities with local businesses to provide assistance with problems these firms are dealing with. Through the first 20 years, with financing from the SBA, these universities served 150,000 small businesses through direct consulting and gave hands on experience to approximately 500,000 university students. This initial funding and development of the SBI program was greatly responsible for the development of small business, entrepreneurship and consulting classes and programs. Even though the funding was eventually cut, there are still approximately 1000 small businesses per year receiving direct consulting support through the SBI. A renewed support for programs such as the SBI on university campuses nationwide can assist in getting more information and expert help to our struggling small businesses, thus creating a positive economic impact.

## **Conclusion**

Thank you, committee, for the opportunity to present my views of the current struggle of small businesses. I do believe that, regardless of the form or source, small businesses still need help to remain a vital part of the economy and to remain essential for economic growth and employment. Though economic times can be difficult, the innovation and determination of the small business owner and operator can lead them to success. If we can continue the focus on providing the necessary resources, small businesses will be successful and will better our nation.