United States House of Representatives
Committee on Small Business

Testimony of Matthew J. Slaughter
"Large and Small Business: How Partnerships Can Promote Job Growth"

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Committee Chairman Graves, Ranking Member Velazquez, and fellow Members, thank you very much for inviting me to testify on these important and timely issues regarding how partnerships between large and small businesses can promote job growth.

My name is Matt Slaughter, and I am currently Associate Dean and Signal Companies' Professor of Management at the Tuck School of Business at Dartmouth, Research Associate at the National Bureau of Economic Research, and Senior Fellow at the Council on Foreign Relations. From 2005 to 2007 I also served as a Senate-confirmed Member on the Council of Economic Advisers, where my international portfolio spanned topics on the competitiveness of the American economy.[1] More recently I was a founding member of the Squam Lake Group, a non-partisan group of 15 academics who initially came together in the fall of 2008 to offer guidance on the reform of financial regulation amidst the World Financial Crisis.[2]

The topic of today's hearing is extremely important. The news for American workers has improved somewhat in recent months: the rate of net job creation has accelerated, and the unemployment rate has fallen. But in many ways the U.S. labor market remains quite damaged, a fact stressed by Federal Reserve Chairman Ben Bernanke in a speech he delivered yesterday in which he said, "We cannot yet be sure that the recent pace of improvement in the labor market will be sustained." Today America has 110.7 million private-sector payroll jobs. The first time the U.S. economy reached that same numbers of jobs was twelve years ago, in March of 2000. America has created no new private-sector jobs in over a decade, during which time its civilian labor force has expanded by about 15 million people. The result is that today over 23 million Americans, nearly one in six in the entire labor force, are unemployed or under-employed.

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[1] In the past two years, I have not received any Federal research grants. Currently, in addition to the affiliations listed above I serve as a member of the academic advisory board of the International Tax Policy Forum; an academic advisor to the Deloitte Center on Cross-Border Investment; a member of the Congressional Budget Office's Panel of Economic Advisers; and a member of the U.S. State Department's Advisory Committee on International Economic Policy. For many years I have consulted both to individual firms and also to industry organizations that support dialogue on issues of international trade, investment, and taxation. For a listing of such activities, please consult my curriculum vitae posted on my web page maintained by the Tuck School of Business at Dartmouth.

[2] The book our Group co-authored that discusses the challenges in understanding and aiming to prevent financial crises is *The Squam Lake Report: Fixing the Financial System*, with Kenneth R. French, Martin N. Baily, John Y. Campbell, John H. Cochrane, Douglas W. Diamond, Darrell Duffie, Anil K Kashyap, Frederic S. Mishkin, Raghuram G. Rajan, David S. Scharfstein, Robert J. Shiller, Hyun Song Shin, Matthew J. Slaughter, Jeremy C. Stein, and Rene M. Stulz; Princeton University Press, June 2010.

In my remarks, I will stress that to address this central challenge facing America of spurring private-sector job creation, one of the most effective ways to support job growth in small businesses is to support job growth in big businesses. This is because of neither small business nor large business operates in a vacuum. Each is deeply embedded in the overall U.S. economy, with extensive connections to each other—especially through the supply chain selling to each other intermediate inputs, i.e., the goods and services used as inputs in the production process.[3]

Small and Big Business in America: Long-Term Contributions of Each

Let me start by stressing that small and big businesses have long helped strengthen the U.S. economy and each other. Start with the direct purview of this committee, small businesses. The Small Business Administration, an independent federal government agency charged with monitoring and supporting America's small businesses, defines a small business as an independent business with fewer than 500 employees. SBA's research into these firms has documented many contributions to America of small businesses, including the following.[4]

- Small businesses accounted for approximately 99.7% of the 29.6 million businesses in the United States in 2008. Their collective output accounts for more than half of private non-farm GDP.
- Small businesses accounted for 49.6% of total payroll employment in the United States in 2007: 59.9 million of that year's 120.6 million total payroll jobs. Small businesses also account for about 44% of total private payroll.
- Small businesses accounted for 64% of the net new jobs created in the U.S. economy between 1993 and the third quarter of 2008. Over that nearly 15 years, small firms created a net 14.5 million jobs out of the economy's total of 22.5 million. It is *young* small businesses that are especially important here: over the past generation, small businesses less than two years old have accounted for about 25% of gross job creation.[5]

Let me next emphasize that *multinational companies, which tend to be among America's biggest, have, like small businesses, long helped strengthen the U.S. economy*.[6] The many channels of the contributions of these companies—both the U.S. parents of U.S.-based multinationals and also the U.S. subsidiaries of foreign-based multinationals—are well documented and researched. Multinationals enhance the American economy by their capital investment, their exports, their research and development, and by supporting good-paying American jobs.[7]

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[3] Portions of my testimony draw closely on the findings of my 2010 study, *Mutual Benefits, Shared Growth: Small and Large Companies Working Together*, prepared for Business Roundtable.

[4] Small Business Administration, Office of Advocacy. *Frequently Asked Questions*. Updated September 2009.

[5] Haltiwanger, John C., Ron S. Jarmin, and Javier Miranda. "Who Creates Jobs? Small vs. Large vs. Young." National Bureau of Economic Research Working Paper #16300, August 2010.

[6] A U.S.-based multinational company is any U.S. enterprise, called the "parent," that holds at least a 10% direct ownership stake in at least one foreign business enterprise, called the "affiliate." In 2009, which at the time of writing is the most recent year of data available on U.S. multinationals from the Bureau of Economic Analysis of the U.S. Department of Commerce, there were 2,347 U.S. multinational parents that controlled 25,424 foreign affiliates.

[7] See, for example, "A Warning Sign from Global Companies," by Matthew J. Slaughter and Laura D'Andrea Tyson, *Harvard Business Review*, March 2012. See also *Growth and Competitiveness in the United States: the Role of Its Multinational Companies*, McKinsey Global Institute research report, June 2010. See also *American Jobs, American Infrastructure, and American Global Competitiveness*, by Matthew J. Slaughter, Organization for International Investment research report, spring 2011.

Multinational companies perform large shares of America's productivity-enhancing activities that lead to high average compensation for American workers. For the most recent year of data available, 2009, contributions of these companies' U.S. operations included the following.

- *Output*: Multinational companies produced $2.97 trillion in output (measured in terms of gross domestic product), which was approximately 28.7% of all private-sector output.
- *Capital Investment:* Multinational companies purchased $553.6 billion in new property, plant, and equipment—40.9% of all private-sector non-residential capital investment.
- *Exports:* Multinational companies exported $757.5 billion of goods to the rest of the world, 71.1% of the U.S. total.
- *Research and Development:* To discover new products and processes, multinational companies performed $238.4 billion of research and development. This was a remarkable 84.2% of the total R&D performed by all U.S. companies.
- *Jobs and Paychecks:* All these productivity-enhancing activities contribute to large average paychecks for the millions of employees of multinationals. These companies employed about 27.4 million U.S. workers. This was 24.4% of total private-sector payroll employment. Total compensation paid by multinational companies was over $1.9 trillion—a per-worker average of $69,796, about 25% above the private-sector average.

Despite the long-term contributions that both small and large businesses have made to the U.S. economy, today it is many small businesses in America that are struggling most to recover from the World Financial Crisis and Great Recession. The most-recent monthly survey of U.S. small-business economic trends by the National Federation of Independent Business summarizes activity that remains "still historically low"—indeed, slightly below where it was one year ago.[8]

Why are so many American small businesses struggling so much? Clearly, one important reason has been tighter access to credit because of the World Financial Crisis. But this is by no means the only challenge that needs to be addressed. It is important to recognize that today few small-business owners cite access to credit as their single biggest challenge. Rather, the most-cited biggest problem is poor sales. Here is the breakout of their most-recent responses to the monthly NFIB survey item, "What is the single most important problem facing your business today?"

Problem	Percent of Respondents
Poor Sales	22
Taxes	21
Government Regulation	21
Inflation	9
Cost/Availability of Insurance	7
Big-Business Competition	5
Quality of Labor	5
Finance and Interest Rates	4
Cost of Labor	3

[8] Dunkelberg, William C., and Holly Wade. *NFIB Small Business Economic Trends: March 2012*.

This NFIB survey finds that for every one small business owner who today says access to credit is the biggest problem s/he faces, more than five other small-business owners are saying poor sales is the biggest problem. This suggests that a major reason small firms are not hiring or investing aggressively is lack of customers making purchases. *The bottom line is that a paramount challenge facing the U.S. economy today is to help small businesses, and one of the most important ways is to boost their sales and thereby boost their hiring and capital investment.*

How Small Business and Big Business Work Together: The Supply-Chain Partnership

Neither small business nor large business operates in a vacuum. Rather, each is deeply embedded in the overall U.S. economy—with extensive connections to each other in product markets, capital markets, and labor markets.

One important link between small business and big business is time: small businesses of today can grow to become the big businesses of tomorrow. Many of America's largest and most-successful companies started small—indeed, as the quintessential person pursuing a dream from a garage or dorm room. This dynamic perspective is very important. The distinction at any point in time between small and large businesses is not permanent. Many small businesses aspire to grow large, and many innovative firms manage to do just that—often quite quickly.

Another important link between small business and big business is their supply-chain partnership: each set of companies sells to the other intermediate inputs, i.e., the goods and services used as inputs in the production process. To make their own goods and services, large companies buy many of their most important intermediate inputs from small companies—and vice versa. Input suppliers and their customers can strengthen each other, not just by the latter generating sales for the former but through many other channels such as sharing information and performance standards.

Of particular note here are small companies selling intermediate inputs to U.S.-based multinational companies. The potential scope for this link between U.S. multinationals and their small-business suppliers is very large, because of how very large are the input purchases of U.S. multinational firms. *In 2008, the U.S. parent operations of U.S.-based multinationals purchased $6.33 trillion in intermediate inputs, which was 72.5% of their total sales that year of $8.73 trillion. Of this $6.33 trillion in total input purchases, 88.8%—$5.62 trillion—was bought from other companies in the United States.*[9]

Contrary to the common assumption that the global engagement of U.S. multinationals has eliminated their ties to domestic suppliers, nearly 89 cents out of every dollar spent by U.S. parents on intermediate inputs is paid to other companies in the United States, not companies abroad. And this heavy reliance on domestic suppliers has been virtually unchanged for decades: in 1977, U.S. parents purchased 91.3% of their inputs from other companies in the United States.

[9] Total purchases of intermediate inputs by parent companies are calculated as total sales less value-added output. Imported intermediate inputs are measured as total parent imports of goods. This implicitly assumes that all imported goods by parent companies are intermediates rather than final goods. Because some of these imports are final goods and services rather than intermediates, the calculated share of inputs bought from domestic suppliers reported above lies *below* the true domestic-supplier share.

But *of these trillions of dollars in intermediate-input purchases by U.S. multinationals, how much is bought from small businesses in America? Surprisingly, this question cannot be answered by any data collected by the various statistical agencies of the U.S. government.*[10]

Given this gap in official U.S. government statistics, in 2010 I worked with the Business Roundtable, an association of chief executive officers of leading U.S. companies, to conduct an original survey of its members to learn about the role of small businesses in their supplier base. Extrapolation from these survey results provides estimates of how large is the partnership between U.S. multinationals and U.S. small businesses.

During mid-2010, each Roundtable member company was asked to respond to the following questions about their interactions with small and medium-sized enterprises in the United States (SMEs, consistent with the SBA, defined as companies with fewer than 500 employees).

1. How many American SMEs provide products and services to your company in the United States?
2. What is the dollar value of total input purchases (products and services) by your company in the United States from American SMEs?
3. What percentage of the total input purchases (products and services) by your company in the United States is from American SMEs?

The reporting burden of these questions was quite high. Despite this high information requirement, 64 Roundtable companies—37.9% of the total—provided complete responses to the survey. These 64 responding companies account for about 3.0% of the total number of U.S.-based multinationals operating in 2008. However, the global revenue earned by these 64 responding companies accounted for a sizable 21.3% of the total revenue earned by all U.S. multinationals. Moreover, responding companies span the complete range of industries such as manufacturing, IT, telecommunications, finance, retail, transportation, and health care. The combination of the size and industry breadth of these 64 responding companies suggests that their collective responses will be reasonably representative of all U.S. multinationals.[11]

For each of the three survey questions, the average (i.e., mean) responses were as follows.

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[10] Surveys underlying the BEA data on U.S. multinationals do not ask firms to report anything about the number or size of their supplier base. The SBA Office of Advocacy does not collect any information about the size of the customers of small businesses—e.g.., whether they serve any U.S. multinationals. Surveys of establishments in manufacturing and other industries that constitute the Longitudinal Research Database of the U.S. Bureau of the Census do not ask plants to report anything about the number or size of their suppliers. And the national input-output tables constructed by BEA do not collect or report information about the size of suppliers to industries.

[11] The 64 survey responses show no obvious sign of response bias; in particular, by industry different from the industry mix of U.S. multinationals overall. Just as manufacturing's share of U.S. multinationals exceeds manufacturing's share of the U.S. economy overall (about 20% of GDP and less than 12% of private-sector employment), the share of responses coming from firms predominantly in manufacturing exceeds manufacturing's share of the U.S. economy overall. There was also no clear evidence of non-response bias: many companies from many industries stated they were not responding simply because they do not collect the data requested. And the overall response rate of 37.9% exceeds the response rate of many commonly used surveys. The revenue share of 21.3% was calculated using BEA data and responding-company data for 2007, the most-recent year of BEA data available during the period in which this report's survey was conducted and tabulated.

1. How many American SMEs provide products and services to your company in the United States?

   Average Response: 6,246

2. What is the dollar value of total input purchases (products and services) by your company in the United States from American SMEs?

   Average Response: $3.27 billion

3. What percentage of the total input purchases (products and services) by your company in the United States is from American SMEs?

   Average Response: 24.7%

Taking these survey results as representative of all U.S. multinationals, then the U.S.-parent operations of the typical U.S. multinational buys goods and services from 6,246 American small businesses; buys a total of $3.27 billion in inputs from these small-business suppliers; and relies on these small-business suppliers for over 24% of its total input purchases. The bottom line of these results is that the supply-chain partnership between U.S. small and big businesses is deep and essential to each other's economic success.

Extrapolating from these survey results can provide an estimate of the total amount of intermediate inputs that the parent operations of all U.S. multinationals buy from U.S. small businesses. As calculated above, respondents' average share of total input purchases accounted for by small businesses is 24.7%. This share is quite robust to alternative methods of calculating averages; a conservative summary of several alternatives would peg it at 24%.[12]

Assume, then, that all the U.S.-parent operations of U.S. multinationals purchase 24% of their intermediate inputs from small U.S. businesses. Earlier, this report stated that in 2008 these parents purchased a total of $6.33 trillion in intermediate inputs. *Then the U.S. parents of U.S. multinationals collectively purchase an estimated $1.52 trillion in intermediate inputs from U.S. small businesses* (i.e., 24% of $6.33 trillion).

How large a share of the total sales of U.S. small businesses is this $1.52 trillion? In 2007, total revenues for all U.S. small businesses were $12.37 trillion.[13] *This means that input purchases by the parent operations of U.S. multinationals account for an estimated 12.3% of all sales by U.S. small businesses.*

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[12] The averages reported in the text are "simple" means, which are calculated weighting equally the response of each of the 64 companies. The corresponding median responses (i.e., the response of the "middle" company when all 64 responses are arrayed from smallest to largest) to the three survey questions are 2,734; $0.98 billion; and 19.5%. For the share of total input purchases coming from small businesses, several alternative means were calculated using different size-based weights. This resulted in the following range of weighted means: 35.49% (weighting each response by the company's inputs purchased from small businesses); 24.27% (weighting each response by the company's total input purchases inferred from its reported share and level of small-business input purchases); 24.23% (weighting each response by the company's 2009 global revenues); and 23.99% (weighting each response by the company's 2007 global revenues).

[13] This total-sales figure is calculated from data available at www.sba.gov/advo/research/data.html. At the time of writing this testimony, SBA has not released sufficient information to calculate total small-business sales for 2008. Given that total U.S. GDP is reported by the BEA to have fallen by 0.3 percent from 2007 to 2008, the 2008 total sales for U.S. small businesses were likely very similar to the 2007 amount.

Conclusions and Policy Implications

Small and big businesses in America are connected to and working with each other through their supply-chain partnership. The parent operations of U.S. multinationals buy an estimated 24% of all their intermediate inputs from U.S. small businesses—an estimated $1.52 trillion in total, which is about 12.3% of all sales by U.S. small businesses. Let me close by offering three brief policy implications of the supply-chain partnership.

One important policy implication follows from this analysis: government policies targeted at just small business or at just big business affect all firms, not just firms of a particular size. So, government policies should be aiming to promote investment growth and job creation for all U.S. businesses. Think of exporting. Policy support targeted at small businesses—such as greater access to information about how to enter into export markets—will help big business by strengthening an important part of its supplier network. Similarly, policies to support growth of big business—e.g., trade and investment agreements to expand their exports—will boost their input purchases from small businesses. Because of the supply-chain partnership, there are lots of small U.S. businesses engaged in the global economy by supplying large U.S. exporters—even if they themselves do not export directly.

A second important policy implication is that the supply-chain partnership between large and small businesses will almost surely become more important, not less so, in the future. A distinguishing feature of the integration of the global economy over the past generation has been, paradoxically, the disintegration of production. Through the use of sophisticated technology networks, companies increasingly operate within elaborate global production networks in which final products are made in many stages spanning many countries, linked together primarily by the international trade and investment of multinational companies. These networks have contributed to not just the multinational companies at their core but also to their small-business suppliers as well. As the global economy continues to grow in size and diversity, so, too, will the supply-chain partnership between large and small businesses.

A third important policy implication is that to better understand the partnerships between large and small businesses, U.S. government data need improving. My survey about the big-little supply-chain partnership I needed to conduct because U.S. government statistics currently cannot capture the extent and evolution of this partnership. This is in no way a fault of the dedicated public servants that work at statistical agencies such as the U.S. Bureau of the Census. Rather, it simply reflects the fact that many of the business surveys conducted and analyzed by these agencies were created decades ago in ways that are not rich enough to adequately capture the evolving complexity of business in America. Here in the 21^{st} century, if we want to craft U.S. economic policies that reflect the reality of this complexity and thus that better support U.S. job creation, then we need to find a way to update and expand many of our key economic statistics.

Let me close by thanking you again for your time and interest in my testimony. I look forward to answering any questions you may have.