

## 10 Things Small Businesses Won't Tell You

*Who are these "job creators," and how did they get so many government agencies working for them?*

By **IAN SALISBURY** | SEPTEMBER 9, 2012

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### 1. "We only look small next to Exxon."

The idea of big business doesn't exactly give most Americans the warm fuzzies, with the BP oil spill, the banks' role in the financial crisis, and Big Tobacco's many historic obfuscations representing only a few of the corporate misdeeds that have turned consumer sentiment against it. Small business, in sharp contrast, ignites a flame of good feeling among many. Indeed, it seems to rank in Americans' imaginations somewhere between Mom and little league baseball.

Politicians know that -- and in an election year, they're not shy about exploiting it. The White House website proclaims that small-business owners "are on the front lines of strengthening America's economy while helping the country rise to the many challenges of the 21st Century." Not to be outdone, Republican presidential candidate Mitt Romney insists he hears from small business "day in and day out," and he lists being a "champion of small business" as one of the five pillars of his plan to boost the economy.

Just who are these individuals hailed as "champions of change" (by President Obama) and "job creators" (by Romney)? It turns out, the answer isn't simply the woman down the block trying to get her boutique off the ground, or the apron-wearing man ringing you up at the cash register of your local hardware store. It's a lot more complicated.

When Congress passed a rare bipartisan economic-development bill this year, the Jumpstart Our Business Startups Act, for instance, the businesses reaping many of the rewards weren't exactly tiny. While the Act did partly address pothole issues like cutting regulatory paperwork, other provisions dealt with issues that truly small businesses almost never deal with, like initial public offerings and hedge-fund marketing. Despite the hoopla, many JOBS Act provisions "are not top priorities" for mom-and-pop businesses, says Kevan Chapman, a spokesman for the National Federation of Independent Business, a lobbying group that represents companies that typically employ about 10 workers.

Like Congress, the Small Business Administration also takes a the-more-the-merrier approach. By its count, 99.7% of businesses in America qualify as small, possibly making them eligible for special aid. (About half of all private-sector workers are employed by small businesses, however.) So just how big can a

small business be? In general, the government contracting standards accommodate firms with up to 500 employees -- but the cap can get as high as 1,500 for industries that are dominated by conglomerates, such as oil-refining or aircraft-manufacturing.

That has some experts crying foul, saying the SBA handouts are just another out-of-control government program. "Everyone is a small business," says Veronique de Rugy, senior research fellow at the Mercatus Center, a right-leaning think tank. "It's meaningless."

## **2. "We're not the job creators you think we are."**

If there's one thing most people think they know for sure about small businesses, it's that they're important to the economy. "Small business has created about two of every three net new jobs in the United States since at least the early 1970s," says the National Federation of Independent Business. The same stat has also been touted by the White House.

The only problem is that economists who have studied job creation aren't entirely sure it's accurate. While consensus has gone back and forth over the years, one recent study by researchers at the Census Bureau and the University of Maryland suggests the notion is only partly true. Although on balance, small businesses do create more jobs than big ones, the study found, there is a big catch: The job growth doesn't have much to do with their smallness. It only has to do with youngness -- that is, being a start-up. In fact, after the authors controlled for company age, they found "no systematic relationship between firm size and growth."

While few dispute the notion that a culture of entrepreneurial striving is key to the success of American business, many experts say it's a mistake to assume all small-business people -- doctors, lawyers, plumbers --- are aflame with ambition. Nearly half of new businesses provided an existing good or service to an established market, according to a study from the University of Chicago. Most entrepreneurs cited benefits like "wanting flexibility over schedule" and "to be one's own boss" over potential riches as their prime motivator in starting a business.

## **3. "We don't have any monopoly on innovation."**

The small inventor with a big dream is an American icon, an idea that runs all the way from Ben Franklin flying his kite to a long-haired Steve Jobs founding Apple in his garage. While there's certainly some truth to the lore, don't forget that Jobs also found inspiration outside his business -- it was on a visit to Xerox PARC that he saw a demo of a mouse and graphical user interface, and realized their commercial potential -- and that many Apple achievements, like the iPod and iPad, appeared long after the company had become a big business.

The lesson, say experts, is that the less romantic contributions of faceless conglomerates, universities and -- gasp -- the government may be just as or

more important to the march of technological progress. One indication: Of the 13 Nobel Prize winners affiliated with U.S. businesses, as opposed to a more traditional perch like academia, all have come from just three well-known (and very large) companies: IBM, AT&T and Texas Instruments, according to a recent study by the Progressive Policy Institute. Just one winner came from a start-up: Guglielmo Marconi, in 1909.

One reason is, big companies can afford to spend far more on research and development -- more than \$3,300 a year per worker for the largest companies, versus about \$800 for small ones, according to the PPI study. There are some industries where small companies have a very hard time innovating: While creating a Web-based business, for example, can be achieved at little cost, when it comes to industries like health care, energy or transportation, it's a different story, according to the PPI study's author Michael Mandel. "These problems need to be tackled on a bigger scale," he says.

#### **4. "We're a bunch of white guys."**

To hear many politicians tell it, the defining characteristic of small-business owners is merely "success." But a look at the numbers suggests that being born into the right demographic bucket makes a big difference. While the white population of the U.S. is about six times the black population, the number of white-owned small business establishments is 53 times that of blacks, according to recent government data. And men own twice as many businesses as women.

To be sure, not all minorities are behind: Asians were slightly more likely than whites to own a small business and, in a separate study, the SBA found that immigrants had higher ownership rates than other Americans, typically leaning on personal or family savings to get the ball rolling.

Moreover, the feds have worked to correct historical imbalances, with rules that direct government contracts to women and minorities in order to foster equal opportunity. But that displeases many on the right, like Cato Institute budget analyst Tad DeHaven, who has argued on the libertarian think tank's Downsizing the Federal Government blog that the government's small-business bureaucracy "shouldn't be in the business of favoring -- or disfavoring -- any race."

#### **5. "You're better off working for a megacorp."**

It may be great to be a small-business owner, but working for one is another matter altogether. For all the cracks about soulless cubicles and numb middle management, some argue that by most tangible measures, it's better to work for The Man. "Simply put, large firms offer better jobs and higher wages than small firms," concludes a recent study by the Federal Reserve. On average, workers at firms with more than 2,500 workers earned \$27.05 an hour, compared with just \$15.69 for those at firms with fewer than 100. Workers at big companies were also more likely to have employer-sponsored health insurance and enjoy other perks like retirement plans and paid vacation.

There are some caveats: While salary figures held largely across the board, there were notable exceptions, like retail and health care, where workers at the biggest companies made slightly less than their small-company counterparts. Sorry Wal-Mart.

Of course, small-business advocates say, job satisfaction can go way beyond the paycheck. Workers at small companies often have perks like face time with the boss, the chance to get out from behind the cubicle wall and to take on a bigger range of tasks -- think of an innkeeper that welcomes the guests, plans the menu, cleans the rooms and manages the marketing, versus someone that waits tables in the restaurant of a giant hotel chain.

"You have a little more responsibility and opportunity," says Charles Purdy, senior editor at job website Monster.com "There is a feeling of satisfaction."

## **6. "Others have regulators, we've got a friend..."**

The federal government has plenty of departments that regulate a particular segment of the economy, like the Departments of Agriculture or Energy. But experts say few, if any, cheerlead as unabashedly as the Small Business Administration, which gushes -- you may have heard this before -- that "small business is America's most powerful engine of opportunity and economic growth" and which promises to be "the voice of small business on Capitol Hill."

That kind of boosterism rubs many, even on the frequently business-friendly right wing, the wrong way. De Rugy, who has called for the Small Business Administration to be abolished, doesn't mince words: "It's a taxpayer-funded interest group." While the agency's annual budget request -- about a billion dollars -- is small by federal standards, it routinely spends much more because of the loan guarantees it offers to small businesses. Actual outlays eclipsed \$6 billion in 2011, according to de Rugy, although with the economy healing, that figure is expected to be only about \$3 billion this year.

For its part, the SBA says, "when the market operates properly," small businesses don't need any help from government. "But, oftentimes, there are viable small businesses that can't get a conventional loan. This is when the SBA can help."

## **7. "...And that's just a taste of the gravy we get from Uncle Sam."**

Even bigger than the SBA's loan guarantees are federal rules that require agencies to direct a slice of their spending on everything from hammers to guided missiles to small businesses, with significant portions going to ones owned by groups like women or veterans. Lest they slide, each agency gets an annual grade handed out by the SBA: Department of Health and Human Services, A. Housing and Urban Development, C.

Advocates of so-called set-asides argue they're not about favoritism, but rather about making sure small-business people aren't overlooked by the government's

giant bureaucracy. "The federal government gets the chance to work with some of the most responsive, innovative and nimble companies in the U.S. -- often with a direct line to their CEO," says an SBA spokesperson. It's "a win-win."

Last year, the federal goal of spending 23% of all purchases with small businesses translated into more than \$90 billion dollars worth of checks written by Uncle Sam to Mom and Pop. To put that in context, that's \$10 billion less than the government lent to students last year, but about \$15 billion more than it spent on food stamps.

Not everyone is happy about the arrangement. Critics, like Cato's DeHaven, point to recent scandals like one in which small companies ostensibly owned by Alaskan natives turned out to be fronts for larger, nonminority business interests. "With so much money at stake, abuse is unavoidable," he says.

### **8. "The tax code favors us -- when we pay."**

While nothing about taxes is ever simple, at least some experts on the left and the right point to a number of provisions in the tax code that tend to favor small business. One big leg up: Most Fortune 500 companies pay income tax on their profits before handing whatever is left over back to shareholders in the form of dividends. Hence the infamous "double taxation" that many economists say justifies a lower tax rate on dividends. By contrast, the vast majority of small-business owners simply report profits as income on their individual returns, paying once. The upshot: Profits earned by big business are often taxed at a combined rate of up to 44.75% while mom-and-pops pay only up to 35%.

There are some big caveats. Not all large businesses pay corporate income tax, and some small ones do. Many people would argue that those who sweat to get a new enterprise off the ground deserve a lower rate than their neighbors who simply collect monthly dividend checks.

At the same time, big companies are famous for finding inventive ways to minimize -- or even reverse -- their tax bills. Last year, the New York Times won a Pulitzer Prize in part for explaining how General Electric claimed a \$3.2 billion tax credit on profits of more than \$14 billion in 2010. Far from being able to take advantage of the complexity of the tax code, many small businesses say they are strangled bit it. One recent SBA study found that small businesses spent three times as much per employee complying with IRS rules as large ones.

Of course, little guys have tax avoidance methods too. Ever had a contractor offer you a discount if you paid in cash? The IRS estimates unpaid taxes amounted to \$450 billion for 2006, the latest year studied, and small business -- accounting for \$179 billion -- was the biggest culprit. While large employers have huge record-keeping operations, small fries often work on the honor system. "There's no third-party check," says Eric Toder, a tax expert with the left leaning Urban Institute. "They have the opportunity."

## **9. "We're old buddies with politicians."**

If small businesses has one constant complaint it may be that bureaucrats and career politicians don't understand their needs, saddling them with red tape and "silly" rules. But many Washington insiders say, in fact, almost nobody has the ear of politicians to the extent small businesses do. After all, most Congressional representatives started out as would-be assemblymen, giving speeches before the Rotary Club. "Go to any list of local big wigs," says economist and George Washington University law professor Neil H. Buchanan. "There's the guy whose name is on the Chevy dealership."

This year, the U.S. Chamber of Commerce, which represents 3 million businesses, won the gold medal in "Washington's Influence Olympics," sponsored by the watchdog group OpenSecrets.org, after pouring \$460.1 million into its lobbying effort in between 2008 and 2011. The Chamber also won the equivalent of the 100-meter dash, spending another \$55.3 million in the first six months of 2012.

To be sure, the Chamber also represents interests like big banks, which have been pushing politicians hard in the wake of the financial crisis. But there's also the National Federation of Independent Business. Among the NFIB's priorities are things almost any American would love, like simplifying the labyrinthine tax code. Others, such as its support for the elimination of the estate tax are far more controversial. While not as famous as the Chamber, insiders say there is little doubt it's a powerful force. The name of the Supreme Court case that recently came within a single vote of nullifying the Obama Administration's controversial health-care law: National Federation of Independent Business v. Sebelius.

"We just pounded the issue again and again," says Karen Harned, executive director of the group's legal center. "We were aggressive."

## **10. "The local press handles our PR."**

With newspapers struggling to cope with declines in mass circulation and the kind of low-rent advertising that for decades dominated classified sections, they're desperate to attract the ever-more-affluent readers that brand-name companies hawking cars, watches and mutual funds want to reach -- readers such as small-business owners, experts say. "They're the perfect scenario for advertisers," says University of Mississippi journalism professor Samir Husni. "They want someone who has money and who has the authority to spend it."

While this doesn't necessarily mean softball stories, some experts have argued that the media has a big incentive to shape coverage around these readers' sensibilities, by assigning reporters to profile tech entrepreneurs, say, rather than chronicling problems at inner-city housing projects.

In small towns and cities, boosterism can be even less subtle. Although, local papers may be fading, radio and television remain strong. That's often great news for those that don't live in a big city served by a national paper (and for

those that love to high school sports scores). For better or worse, however, many of these publishers and station owners are small-business people too. When the zoning board has to decide whether to approve a new subdivision or convention center, they can often see dollar signs every bit as much as contractors and real estate brokers, according to critics like John Logan, a sociologist at Brown University.

"There is a growth point of view," he says. "It's a vested interest."