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U.S. Chamber of Commerce on Small Business Investment Policy and Advocacy Act of 1977

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Statement of the
CHAMBER OF COMMERCE OF THE
UNITED STATES OF AMERICA

on: The Small Business Investment
Policy & Advocacy Reorganization
Act of 1977, (S. 1726)

to: Subcommittee on Economic Growth
& Stabilization, Joint Economic
Committee and the Subcommittee
on Government Regulation & Small
Business Advocacy, Senate Select
Committee on Small Business

by: Dr. Richard L. Lesher & Duane
D. Pearsall

date: June 29, 1977
Mr. Chairman, my name is Richard L. Lesher. I am President of the Chamber of Commerce of the United States.

With me is Duane D. Pearsall, President of the Statitrol Division, Emerson Electric Company, of Lakewood, Colorado, and a member of The Council of Small Business of the National Chamber.

The National Chamber is a business federation of more than 64,000 business firms, over 2,500 state and local chambers of commerce, more than 1,100 trade and professional associations and more than 30 American Chambers of Commerce abroad.

It is important for the members of these two subcommittees to know that most business members of the National Chamber are small. Recent analyses show that more than 83 percent of our business members employ fewer than 100 persons. Almost 72 percent of these firms employ fewer than 50 persons and almost half of all our member companies--46 percent--employ fewer than 20 persons.

In short, the National Chamber membership reflects the broad spectrum of American business, and most business is small.

We are pleased to be invited to offer testimony on the role and status of small business in general and on the bill before you in particular.
We applaud the emphasis given investment in this hearing. Investment is at the core of national well-being, for only investment can create new jobs, new products and new technology to keep us competitive—as individual companies and as a Nation. Clearly there is a special need for attention to investment needs of small business, since so much of small business capital must be generated internally, rather than through issuance of securities. The ability to retain capital is crucial for small business.

We applaud the further exploration of the role of small business in the economy. One of the great needs of this exploration is more data, for we now have available extensive information about the relatively few large companies at the top of the size pyramid, but little reliable information on the operations of the vast majority of our companies.

We particularly applaud the emphasis on the small business problems created by government itself. Our smaller members tell us that they consider government to be their number one problem, for reasons which include regulation and paperwork imposed on them by government. The public sector is the most rapidly-growing segment of the economy, and that sector now takes more than 40 percent of national income. Privately employed individuals and companies compete for a diminishing share of the total. As a consequence, the business system does not show the vigor and the ability to provide jobs to the extent we would like; the resulting squeeze hurts the small and the weak most severely.

We are pleased that through Mr. Pearsall we can illustrate the problems of finance and investment in small companies. Such companies offer very special possibilities for future national economic growth, and we should be sensitive to those possibilities and to ways that hearings such as this can allow the companies involved and the Nation to benefit from easing some of the special conditions they must face.

We will comment briefly on all these general points and then on the content of the bill itself.
The Role of Small Business in the Economy

Small business has as great a social role as an economic role. Small business is the essence of freedom for the individual who wants to be his or her own boss. It is the essence of freedom of choice for the consumer who wants a wide range of products and services from which to choose. It is the most likely outlet for the individual who has a new idea for product or service. It is a means of supplementing income for millions who hold regular jobs and can operate a production or service business on a part-time basis.

Small business is the life-blood of America.

Small business, like medium and large business, is important to our society and to economic growth, not because of the size characteristic, but because of the different economic functions performed in each instance. Some enterprises are small because of the nature of the business. It is important, for example, that most service businesses remain small so that they can be close to their customers and know exactly what they want.

Some businesses are small just because they are new, and we can all cite the Xeroxes or Polaroids or other firms which started small and became larger. Most businesses do not grow that much, but new companies tend to grow more rapidly than mature companies. They also tend to have higher mortality rates than mature companies have.

Some companies are small because of limited market, and others because of the development of new technology. For example, the rapid growth of mini-computers has stimulated new firms in the production side of the business. The technology has made other small firms more efficient and able to operate viably with relatively limited markets.

Financing Problems of Small Business

Small businesses all too frequently lack effective management and venture capital. Having inadequate capital, they tend to rely excessively on credit. The entire business community today operates on an increasing debt-to-equity ratio, and this is especially true for smaller firms, with the effect of making them more vulnerable to market reverses.
Add to this general problem the fact that small firms must generate most of their capital internally, which means they depend on retained earnings. Excessive government regulations which add to cost and excessive taxation which drains earnings, combine to produce an unintended, but effective, de facto federal policy of restricting the growth of small business.

This same combination debilitates the entire business system, let me add, but its most pernicious effects fall upon those least able to fight back or to withstand adversity: our smaller companies.

Regulatory Burdens of Small Business

Polls consistently show federal regulation at the top of small business problem lists. These companies lack the expertise to keep track of government demands. Hiring the extra staffs or professional advisors to keep them in compliance balloons their costs, but that is the easier part. Actual costs of compliance—in capital expenditures and operations—may convert a thriving company into a marginal operation. Surviving all this, the company may encounter conflicting requirements of two, or more, federal agencies. In complying with one agency, the company violates rules of another.

What is the answer? A government that recognizes that its mandates for new procedures and equipment generate important costs. The Congress and the Administration must develop such a recognition as they write and administer laws. One way is to develop detailed impact studies of the economic consequences of each proposed regulatory program.

Regulation is a vital and appropriate function of government, but it does not come free. The costs, ultimately borne by consumers, must be weighed against the benefits which consumers receive from regulation.

Paperwork Burdens of Small Business

Federal paperwork ranks high on the list of problems our members report to us. The product of regulation and of information gathering, federal paperwork requirements appear to be another well-intentioned effort gone out of control.

Members from small companies tell us they are snowed under by forms and questionnaires. They have difficulty completing the forms they must
execute; they have difficulty affording the staff to do the work; they live in fear that they may not be filing some required report; they question whether the detail or frequency of reports is justified; and they question whether the information they supply is actually used.

The National Chamber has had a long-standing interest in reducing the burdens of federal paperwork. We provided the Commission on Federal Paperwork a substantial body of data about the special problems small businesses face in complying with information requests.

Recently, at the request of President Carter, the Chamber presented 18 recommendations for reducing paperwork burdens. One recommendation was that the House of Representatives require that any bill involving reporting requirements be accompanied by a comprehensive estimate of the potential paperwork impact.

We patterned that recommendation after the rule already adopted by the Senate at the urging of Senator McIntyre, and we commend the Senator for initiating and securing adoption of this rule. It is an example of organizational and management changes necessary to achieve real progress in reducing federal paperwork. I will not dwell further on the subject here, but a copy of our report to the President is attached as an appendix to this testimony.

**Comments on The Small Business Investment Policy and Advocacy Reorganization Act of 1977 (S.1726)**

This legislation attempts to strengthen the Small Business Administration and the voice of small business within the Executive Branch of the federal government by several means.

Title I of the Act would amend the current law in regard to executive staffing of the Small Business Administration and would transform the existing Office of Advocacy to an Advocacy and Economic Research and Analysis Division.

The new Division would have responsibility for collecting data about small and medium-sized business and advocating the small business position before the Congress and the Executive Branch. The effective operation of this Division would provide a stronger voice for small business.
Section 103 of this title adds medium-size business to the data collection responsibility of SBA, calls for setting up a data base and analyzing proposed legislation to minimize potential harmful impact on small business.

The need for more data has been well established. There are cautions, however. Several of the analyses required in this Section will be difficult to use without comparisons with larger units of business. The criteria for defining "small" in terms of data base have not been developed, and this lack will restrict the ability of the Division to establish a data base for small business. Further, testimony in earlier hearings indicates that there is a common practice of setting up data series within Departments and Agencies to meet the objectives of those agencies, without making the data systems compatible. The new data system should be designed to avoid this shortcoming.

Title II of the Act would establish a policy that "all reasonable means" shall be used "to establish private sector incentives that will help assure that adequate capital at reasonable cost is available to all business." The clear implication is that the private sector needs cajoling or assisting to provide for small business debt and equity capital needs.

We suggest, as we mentioned earlier in the testimony, that federal government actions are a chief cause of the shortage of capital. Some federal actions have specific anti-investment effects. For example:

--government-imposed standards and regulations raise costs to business in general and small business in particular, thereby making business less profitable and less attractive as investments;

--some government regulations, such as ERISA pension fund investment guidelines, indirectly dry up sources of investment for any but the largest, most profitable and stable companies.

--persistent federal deficits keep government borrowings high, directly competing with private businesses for the savings of American citizens; and

--inflationary effects of federal policies erode the value of the surtax exemption, to the detriment of smaller corporations.
while driving the owners of unincorporated businesses into higher tax brackets.

We suggest that a Small Business Investment Policy requires that concern for small business be made part of federal policy processes; that the Congress establish an evaluation system that could identify potential adverse effects on small business before laws such as ERISA are passed; that the Executive Office of the President needs to sensitize each Executive agency and department with a concern for small business.

For instance, an amendment to The Employment Act of 1946 showing concern for small business might be a more powerful weapon than a policy statement in the Small Business Act. Executive Orders from the White House could go a long way toward the goal of improving the treatment of small business in federal departments and agencies.

Further, it is not at all clear from the language of Section 201(f) what would be involved in "establishing private sector incentives that will help assure that adequate capital at reasonable cost is available to small business." Who will decide, and under what circumstances, what is "adequate" capital and "reasonable" cost? What factors, if any, would be taken into account that are not currently considered by the SBA or by the managements of Small Business Investment Companies?

Title III would require an annual Small Business Investment Policy report. Subsections (1) through (3) of Section 401(g) call for reporting volume of investment capital now used by small business, prospects for the future and an evaluation of federal policy as it applies to cost and availability. These subsections would provide market information helpful to all participants in the economy and are unobjectionable. Subsection (4), calling for a biennial plan recommending proposals and priorities for carrying out the Small Business Investment Policy in Section 201(f), is objectionable.

Title IV would establish a Small Business Economic Council. Such a Council might elevate the visibility of small business by altering the form of government policymaking, but it is not at all clear that such a change would improve the substance of policymaking on behalf of small business.
Changes of a more basic nature, including suggestions made earlier in this testimony, will be necessary.

Title V of the Act would elevate the Administrator of the Small Business Administration to Executive Level 1, equivalent to Cabinet rank. This elevation and the inclusion of medium-size business among SBA responsibilities in earlier titles, raise questions of the relationship of SBA and the Department of Commerce. Is the latter to serve only large businesses? Does not this proposal set up a divided constituency and service system for the business community?

The needs of small business must be represented more consistently and more broadly in economic policy deliberations throughout the federal government. As in other sections of the Act, provisions of this Title need to be clarified to avoid still more unintended effects and inadvertent conflicts.

Title VI amends the Federal Deposit Insurance Act to require collection and publication of certain data regarding loans to business. As an effort to expand the data base for considering the problems of small business, the intent of this title can be applauded—but cautions are in order. "Credit information" has many dimensions besides those of dollar assets and dollar sales of borrowers which the title calls for. To make an evaluation of the title possible, additional information is needed. For example, what other kinds of credit information are expected to be combined with the data secured under this title? What uses will be made of the information, and by whom? And finally, since this requirement is another paperwork proposal, should it not receive the rigorous cost-benefit analysis suggested earlier for federal reporting requirements?

Mr. Chairman, these have been comments of the National Chamber on the investment needs of small business in general and on the contents of The Small Business Investment Policy and Advocacy Reorganization Act of 1977. Now Mr. Pearsall will relate his own company experience.

Financing and Capital Formation Experience of a Small Manufacturer

My name is Duane D. Pearsall. I am President of the Statitrol Division, Emerson Electric Company, Lakewood, Colorado, and a member of...
The Council of Small Business of the Chamber of Commerce of the United States.

Until the merger of the company with Emerson Electric in March of this year, Statitrol was an independent manufacturer of home smoke alarms and commercial smoke detectors. We were a small business, now thirteen years old, and because of our success, I was named by the Small Business Administration as Small Business Person of the Year for 1976. During the past year I have served on the Task Force on Venture and Equity Capital of the Small Business Administration, and in that capacity I recently presented remarks similar to my report today before the Committee on Small Business of the House of Representatives.

Much of my report consists of a description of the development of our company, which typifies a national problem resulting in the erosion of the numbers of intermediate-sized businesses in the United States.

Our company was formed in 1963 to manufacture a static control device intended to reduce electrostatic charges in photographic dark rooms. Using a homemade instrument to measure concentration of free ions, we accidentally discovered its sensitivity to smoke. This subsequently led to our development of a commercial ionization smoke detector. After three years of hand-to-mouth financing of the development of a technical product, always on the verge of bankruptcy, we convinced a small business investment company (SBIC), in 1966, to invest $250,000 in a seven-year term, 8 percent note with warrants to purchase options on 49 percent of our outstanding stock. I would remind the Committee that in 1966, an interest rate of 8 percent was considered exorbitant. Because of their sound financial advice and assistance, our relationships with the SBIC, Central Investment Corporation of Denver, have been excellent. It proved to be a wise investment for both parties.

Three years later in 1969, with a gradually growing sales volume, we were able to build our first plant for $92,000, with the help of a 40 percent SBA direct loan. These special SBA funds involved an extremely complicated procedure which required that we hire an attorney at a cost of $2,000 to process the paperwork. Under this program, involving a local development company program, we ended up with five mortgages on our building, one of which was issued to ourselves. This loan was subsequently replaced with a 90 percent SBA guarantee loan for a second plant expansion.
In 1971, we introduced a battery powered home smoke alarm. In 1972, almost single-handedly, with the help of a consultant, we influenced the International Conference of Building Officials, a national model building code organization, to require a home smoke alarm in new construction of one- and two-family residences and each apartment living unit. Its acceptance was followed by other model building codes, adopted by municipalities throughout the United States. In 1977 there will be over eight million such devices installed in homes with a potential savings in lives measured in the hundreds.

In late 1975, the first major U.S. corporation introduced a competitive device on national television. Although our own company has grown dramatically, our market share today is less than 10 percent. To meet national competition, it is necessary not only to add research and development staff and facilities, but also to progressively automate our production.

By mid-1976, two of our major independent competitors, who were small businesses, became acquisitions of large corporations. We became visible in the market place as the largest independent smoke alarm manufacturer. However, we began to experience a rapidly decreasing share of the market.

At this point, it became obvious that we could not generate capital through internal sources in sufficient quantities to meet national competition. In reviewing alternatives, our first choice was to become a public corporation. However, because of the unintended effects of ERISA combined with the effects of SEC Rule 144 and with the anticipated costs of underwriting, we could not expect an acceptable stock offering. As further consideration, our major stockholder would not be able to relieve equity due to the constraints of Rule 144.

We next considered starting an Employees' Stock Option Trust (ESOT). But on careful scrutiny we found that because it represents a stock sale to employees, it would not represent a sufficient multiple on earnings to justify and would injure future possibilities of a sale. Historically, ESOT's have been valuable as a low-multiple bail-out method for a low growth company. Again, this alternative was considered unacceptable.
Other alternatives were reviewed, such as a leveraged asset method, the purchase of an existing but inactive public company, etc. The final conclusion, and the only reasonable alternative, was to seek a merger partner. This resulted in the acquisition of Statitrol by Emerson Electric Company, St. Louis, Missouri, effective March 16, 1977. We are very pleased with our new partner and have a renewed confidence to approach the market place from a position of strength and with a new perspective.

Our experience demonstrates very clearly that the unintended effects of legislation, such as ERISA, combined with constraints of SEC, compounded by the inability to generate capital internally for growth, is forcing the elimination of most intermediate-sized, successful companies in the United States. At the same time, these effects contribute to faster growth of major corporations, tending to institutionalize the large manufacturing sector of our economy.

Supplemental Remarks

In my talks to over 3,000 small businessmen in the past year, major concerns of government intrusion involve the burden of government regulations. ERISA, for example, has created exorbitant costs in maintaining pension or profit sharing plans. Because of required outside professional help in the form of legal and accounting services, together with the enormous paperwork burden necessary to maintain their plans, smaller businesses find it more practical to cancel. Minimum annual costs to maintain the smallest plan are estimated at $2,000 to $2,500. Recently insurance firms have started marketing standard format plans, reducing the cost somewhat, but the net effect is still prohibitive. Statitrol Corporation, with an average of 650 employees, expended an estimated $13,000 in costs to maintain the simplest, most liberal form of profit sharing plan possible in 1976. Since most plans require these costs to be deducted from annual contributions, the burden of maintenance is on the employee. We find, ironically, that a typical employee is sacrificing his retirement income in order to comply with government regulations. In addition, of course, his taxes support the agency.
Another major concern of small business is the almost insurmountable problem of product liability. Many small businesses feel they are living on borrowed time because they are walking in the shadow of a product liability suit which guarantees, in most cases, absolute disaster.

My final point involves a recommendation for new legislation for the very small, or "mini" business. Since the definition of small business is necessarily complicated and encompasses some fair sized companies, there seems to be a need to identify the really small business, such as under ten employees, or with gross receipts under $500,000.

Recommendation - new legislation which will allow a precisely defined "mini" business to be exempt from regulations of independent agencies such as OSHA, EPA, ERISA, etc. Such a bill might well restore confidence among several small business owners.

It has been a privilege and an honor to appear before you today. I hope I can always be considered as a spokesman for small business. As a body, we have been the victims of unintended effects of legislation. The resultant negative effects, together with the increasing burden of government paperwork, have undermined the very foundation of our small business sector and, in so doing, has already seriously eroded the foundation of our free enterprise system.

Thank you very much.

Mr. Chairman, Mr. Pearsall and I appreciate this opportunity to explore the important issues of Small Business Investment Policy with you. We will be glad to respond to your questions and we assure you of our willingness to cooperate in future deliberations on this subject by the two committees.