Mutual Benefits, Shared Growth: Small and Large Companies Working Together

Prepared for Business Roundtable

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About Business Roundtable

Business Roundtable is an association of chief executive officers of leading U.S. companies with nearly $6 trillion in annual revenues and more than 12 million employees. Member companies comprise nearly a third of the total value of the U.S. stock markets and pay more than 60 percent of all corporate income taxes paid to the federal government. Annually, they pay more than $167 billion in dividends to shareholders and the economy.

Business Roundtable companies give more than $7 billion a year in combined charitable contributions, representing nearly 60 percent of total corporate giving. They are technology innovation leaders, with more than $111 billion in annual research and development spending – nearly half of all total private R&D spending in the U.S.

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America’s Economic Challenge: Boosting Economic Growth and Job Creation

Several deep challenges are facing the American economy in the wake of the world financial crisis and great recession. Economic growth has been slowing: the annualized rate of growth in U.S. gross domestic product (GDP) has fallen from 5.0% in the fourth quarter of 2009 to 3.7% and then just 1.6% in the first and second quarters of 2010.¹

For American workers and their families, perhaps the most important challenge is that U.S. companies of all sizes have yet to resume vigorous job creation. Peak to trough, in the great recession, the United States economy lost 8.47 million private-sector payroll jobs—a remarkable 7.3%. Thus far in 2010, the entire United States non-farm business sector has created an average of only 95,375 payroll jobs per month—far fewer than is needed to accommodate population growth.²

Federal Reserve Chairman Ben S. Bernanke recently acknowledged that “the economic outlook remains unusually uncertain.” To help better understand this challenging time, this report provides new data and analysis of an important feature of the U.S. economy: how small and big businesses in America are connected to and working with each other for America’s prosperity.

The main findings of this report are the following:

- Small and big businesses have long helped strengthen the U.S. economy and each other.
- Today, U.S. businesses of all sizes are struggling to recover from the world financial crisis and great recession. A paramount challenge for our government is to put in place policies to help all American businesses boost their sales and thereby boost their hiring and capital investment.
- 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. One important connection is the supply chain: small and big businesses selling each other intermediate inputs, i.e., the goods and services used as inputs in the production process.
- According to a new survey of Business Roundtable companies, the U.S.-parent operations of the typical U.S. multinational buys goods and services from more than 6,000 American small businesses; buys a total of more than $3 billion in inputs from these small-business suppliers; and relies on these small-business suppliers for more than 24% of its total input purchases. U.S. small businesses are critically important partners with U.S. multinationals.
- Collectively, U.S. parents of U.S. multinationals purchase an estimated $1.52 trillion in intermediate inputs from U.S. small businesses, which is about 12.3% of their total sales.

¹ As reported in the most-recent GDP report, U.S. Bureau of Economic Analysis, released 8/27/10.
• Government policies targeted at just small businesses or at just big businesses affect all firms, not just firms of a particular size. For example, new trade agreements that generated $1 billion in new exports by U.S. multinationals would boost their input purchases from U.S. small businesses by approximately $174 million.

Small and Big Business in America: Long-Term Contributions, Current Challenges

U.S.-based multinational companies, which tend to be among America's biggest, have long helped strengthen the U.S. economy. The many channels of these contributions are well documented and researched. American companies first and foremost, U.S. multinationals enhance the American economy through capital investment, exports, research and development, and by supporting good-paying American jobs. Their ability to strengthen the U.S. economy is enhanced, not reduced, by their global engagement.

U.S. parent 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, 2008, contributions of these companies’ U.S.-parent operations included the following:

- **Output:** Parent companies produced nearly $2.4 trillion in output (measured in terms of gross domestic product), comprising approximately 22.3% of all private-sector output.

- **Capital Investment:** Parent companies purchased $478.8 billion in new property, plant and equipment, comprising 28.8% of all private-sector non-residential capital investment.

- **Exports:** Parent companies exported $551 billion of goods to the rest of the world, 42.8% of the U.S. total.

- **Research and Development:** To discover new products and processes, parent companies performed $199.1 billion of research and development (R&D). This was 70.3% 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 U.S. multinationals. Parent companies employed more than 21.1 million U.S. workers. This was 18.5% of total private-sector payroll employment. Total compensation paid by U.S. parent companies was more than $1.37 trillion—a per-worker average of $65,066.

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3 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 2008, 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 2,147 U.S. multinational parents that controlled 24,985 majority-owned foreign affiliates. These totals, and all other data for U.S.-based multinationals in this report, refer to non-bank companies because the BEA collects and disseminates very little information on multinationals in banking.

4 See, for example, Growth and Competitiveness in the United States: the Role of Its Multinational Companies, McKinsey Global Institute research report, June 2010.
Like U.S. multinationals, small businesses have also long helped strengthen America’s economy. The Small Business Administration (SBA), 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 contributions of small businesses that include the following.5

- 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-year span, 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.6

Today, however, many small businesses in America are struggling to recover from the world financial crisis and great recession. Federal Reserve Chairman Bernanke recently gave a speech focusing on “the challenges facing small businesses, both in the near term and in the longer run.”7 The two most-recent monthly surveys of U.S. small-business economic trends by the National Federation of Independent Business (NFIB) summarizes activity that remains near historic lows and is again trending down:

The Index of Small Business Optimism lost 3.2 points in June after posting modest gains for several months. The persistence of Index readings below 90 is unprecedented in survey history … The small business sector is not on a positive trajectory, and with this half of the private sector “missing in action” the poor growth performance is not surprising.8

The Index of Small Business Optimism lost 0.9 points in July following a sharp decline in June. The persistence of Index readings below 90 is unprecedented in survey history … Ninety percent of the decline this month resulted from deterioration in the outlook for business conditions in the next six months.9

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American small businesses today are not poised for aggressive hiring or capital investment. NFIB reports the following poor outlook for employment:

Nine percent [of small businesses] reported unfulfilled job openings, unchanged from May and historically very weak. Over the next three months … a seasonally adjusted net one percent of owners planning to create new jobs … Since the third quarter of 2009, job creations have underperformed the recoveries from the other two deep recessions covered by the NFIB survey.\textsuperscript{10}

For capital investment, the outlook is similarly guarded:

The frequency of reported capital outlays over the past six months fell one point to 45 percent of all firms, one point above the 35 year record low reached most recently in December 2009. The percent of owners planning to make capital expenditures over the next few months fell one point to 18 percent, two points above the 35 year record low.\textsuperscript{11}

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. The falling amount of bank loans to small businesses is typically cited as evidence of tight credit. But declining loans can be caused by a combination of forces. As Federal Reserve Chairman Bernanke puts it, “An important but difficult-to-answer question is, how much of this reduction has been driven by weaker demand for loans from small businesses, how much by a deterioration in the financial condition of small businesses during the economic downturn, and how much by restricted credit availability? No doubt all three factors have played a role.”\textsuperscript{12}

\textbf{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. The table on the following page breaks out their most recent responses to the monthly NFIB survey item, “What is the single most important problem facing your business today?”

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 seven 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 NFIB summarizes the problem thus: “What [small] businesses need are customers, giving them a reason to hire and make capital expenditures and borrow to support those activities.”\textsuperscript{13}

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. This report now analyzes one important source of small business sales: the supply chain of big business.

### 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 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 the large 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.\(^{14}\)

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.

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.\(^{15}\)

Given this gap in official U.S. government statistics, Business Roundtable conducted an original survey of its members to learn about the role of small businesses in their supplier base. Extrapolation from these survey results can provide estimates of how large the partnership is between U.S. multinationals and U.S. small businesses.

Survey Design and Structure

Business Roundtable is an association of CEOs of 188 leading U.S. companies with $6 trillion in annual revenues and nearly 12 million employees. During May and June of 2010, each Business Roundtable member company was asked to respond to the following questions about their interactions with small and medium-sized enterprises (SME) in the United States (SMEs, consistent with the SBA, defined as companies with fewer than 500 employees):

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\(^{14}\) 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.

\(^{15}\) 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.
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 very high. Many member companies were not able to answer because they have no established system for tracking the size of their many suppliers (which, in turn, may be partly because such information is not mandated by any U.S. government statistical agency—see discussion above and note 15). Despite this high information requirement, 64 Business Roundtable companies—34% 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 (see note 3). 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 a wide range of industries, including 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 is reasonably representative of all U.S. multinationals.\(^{16}\)

**Survey Results and Estimates**

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

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

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\(^{16}\) 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.
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 more than 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%.17

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.18 *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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17 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).

18 This total-sales figure is calculated from data available at www.sba.gov/advo/research/data.html. At the time of writing, SBA has not released sufficient information to calculate total small-business sales for 2008. Given that total U.S. GDP is currently estimated by the BEA to have been unchanged between 2007 and 2008, the 2008 total sales for U.S. small businesses were likely very similar to the 2007 amount.
**Conclusions and Policy Implications**

The key finding of this report is that 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.

An 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. 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.

Consider how trade and investment agreements that boost exports by U.S. multinationals would also boost the sales of U.S. small businesses: In 2008, parent companies of U.S. multinationals exported to the rest of the world $551 billion in goods—42.8% of total U.S. goods exports. Data presented earlier indicate that every $1 billion increase in their export sales would require about $725 million in intermediate inputs. In turn, a key finding of this report’s survey suggests that U.S. small businesses would provide about 24% of this $725 million in inputs—i.e., provide about $174 million. So, every $1 billion in new exports by U.S. multinationals would boost their input purchases from U.S. small businesses by approximately $174 million.

A related important policy implication is that government policies should be aiming to promote investment growth and job creation for all U.S. businesses—through policies to boost the incentives to invest and hire and policies to eliminate the disincentives to invest and hire. Again, the current U.S. economic outlook is “unusually uncertain.” Sustained economic recovery will come only when businesses of all sizes are growing with vigor. This will require an unusually broad and creative effort to support businesses of all sizes.