

## ***The Social Significance of the Small Business Space***

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In *The Origin of Species*, Charles Darwin presented nature's evidence that all life on this planet was the consequence of an inexorable process of random organic change interacting with a hostile environment to produce an increasingly diverse and complex array of life forms, each capable of surviving in a particular environmental niche. It is plausible that this process ultimately produced sapient humanity from single-celled progenitors. It is equally plausible that human social evolution as deduced from our historical records is a more conscious process, but otherwise analogous to organic evolution. The evolution of the species is determined no longer by the random mutation of genes, but by the potentially conscious effort of humanity to beneficially alter social organization. In this sense social evolution has a similar driving force to organic evolution. What most benefits social success drives the process of social evolution just as what most benefited species survival drove the process of organic evolution. Darwin thus introduced the essential idea of the evolutionary process as one driven by forces beyond the control of individuals. The acts of individuals can promote or impede humanity's social evolution, but, inexorably, humanity will, in the long haul, advance in the direction that is most beneficial to society, even though that direction may be difficult or impossible to discern.

Three hundred years ago the entire population of Europe was under 100 million. Overwhelmingly these consisted of tenant farmers, crafts people, and workers attracted to the factories of the early industrial revolution. Poverty was their accepted way of life. This population was the ancestral source of much of the 300 million people who currently inhabit the United States of America. However, these are predominantly people who own houses and cars and enjoy a standard of living inconceivable 300 years ago. The clearest distinction that can be made between 18th century Europe and 21st century America is the huge increase in society's ability to generate wealth. Since wealth creation has generally been beneficial to society it is not unreasonable to suggest that wealth creation is a de facto beneficial force in social evolution.

Economists summarize wealth formation with a measurable statistic familiar to all of us as the GNP, the gross national product. This is simply the summation of economic exchanges annually recorded in the statistics of a nation's economic activity. It follows that wealth creation is the consequence of the rate of exchange of goods and services. The greater and more productive is this rate, the greater will be the wealth generated.

Over the past 300 years the source of exchangeable goods and services has shifted overwhelmingly from the individual acting alone or with apprentices, to groups of individuals working in concert. We label these latter groups, businesses. It follows that businesses are, today, the major and essential vehicles for wealth creation and thus for the betterment of our society. Nevertheless, business is frequently considered as a necessary evil, and “profit” considered tainted if not immoral. Much of this attitude has roots in the historical process where industrial development and employee exploitation went hand in hand. It is time to clearly recognize that the commercial business has developed through social evolution as an important means for social progress. What has lagged behind is the tuning of the business entity to allow it to most effectively fulfill its evolutionary task.

The startling demise of the Soviet Union focused attention on its failure to achieve anything like the economic performance, not only of the industrialized nations of the West, but even of such third world countries as Korea, Taiwan, and Thailand. In America, the significance of this failure is now largely dismissed as no more than the inevitable consequence of any communist system of government. What can be termed the Soviet Model has simply been totally discredited. This is a comforting conclusion since it reinforces our image of the superiority of our own way of doing things. Perhaps, however, this collapse is placing a faint handwriting on the wall to which we in the West would be well advised to pay greater attention.

Although the Western eye readily notes in the old communist system such defects as the absence of political freedoms, and the lack of attention to human rights, it was the lack of economic pluralism that was most responsible for the sorry plight of the Soviet economy. For instance, the economy of Taiwan has performed well in spite of the absence until fairly recently of any substantial political freedom. Is not the lack of centralized economic decision-making the relevant factor? After all, Taiwan was a “nation of shopkeepers” with huge economic pluralism.

The logic of economic pluralism is the foundation of market economics and Adam Smith’s invisible hand. When millions of potential decision-makers are the resource for a solution to a potential customer desire, that desire will be perceived and solutions offered with astonishing speed and reliability. The centralization of the decision-making function creates the need for godlike prescience in order to achieve comparable performance. Reality has simply demonstrated the enormity of human fallibility.

The productivity that can be brought to support an economic decision is directly related to the extent that such a decision engages the enthusiasm of those asked to produce the solution. The greater the distance between the decision maker and the implementor, the more extravagant must become the monetary incentive required to elicit a productive response. Thus it is not surprising that the totally centralized decision-making authority maximizing the distance interposed between decision-maker and doer, plus the ideological denial of the value of a monetary reward, combined to ensure the dismal performance of the Soviet economy.

Do these lessons to which Russia and the other new nations emerging from the Soviet debacle have responded, resonate in the Western world?

The development of the Western economies has been inextricably entwined with the historical and political realities encountered throughout two centuries of evolution. To what extent do the consequences reflect vestigial rather than essential characteristics? How much of the modern form acquired by our economy is the consequence of historical forces that no longer persist? If economic pluralism is the major lesson to be derived from the collapse of the Soviet Union, substantial doubt must be cast on the validity of our own economic model for carrying our ship of state into the competitive seas of the global economy that will dominate in this twenty-first century.

Within any national economy the plurality of economic decision making and the average distance between decision-maker and implementor is determined by the size distribution of the businesses that constitute the economy. The greater the bias toward large companies, the smaller will be the economic pluralism and the greater will be the average distance between decision-making and execution. Other things being equal, according to the above, this will translate into an economy characterized by lower productivity and poorer responsiveness. It is tending toward the Soviet model! The large company focus of our own economy would thus appear to be at odds with the lessons we should have absorbed from the collapse of the Soviet Union.

The logic of this conclusion does hinge on the qualification, "other things being equal". Persistence in our current focus, therefore, can be justified only by a persuasive argument that indeed other things are definitely not equal. The Soviet model clearly represents the theoretical (if politically impractical) end point in the growth of a national business. The undesirability of the Soviet model must then surely give pause to all those who unthinkingly espouse growth in size as a desirable goal for any public corporation. When, in the growth of any business, does it arrive at a point where further growth is admittedly detrimental? When are all

conceivable benefits that accrue to size more than offset by the disadvantages that lead to lowered productivity and poorer market responsiveness?

Accordingly, the only legitimate economic excuses for growth in any company are (1) because such growth is the necessary means to create the low cost of its product in the marketplace (the vaunted economies of size) or (2) to provide it the resources to undertake desirable projects that would be otherwise unthinkable. Since corporate growth reduces market responsiveness and tends to lower the personal productivity of its labor force, offsetting economies of size or else the magnitude of the desirable corporate task should obviously distinguish the large corporation from the small. A significant percentage of the large company population in America and elsewhere would be unable to offer convincing evidence of either of these fundamental justifications for their size. Such companies are large because of the inertia which stems from the social conviction that all growth is desirable, because of the personal power which accrues to its managers, and because of the uniquely beneficial political and financial environment that large corporations have created for themselves.

Over the past generation monumental changes have occurred in our society. These hugely impact on the rationality of the large corporation. Reliable road and air transportation and travel, commodity production of an increasingly broad range of products and services, from microprocessor chips and world-wide parcel delivery, to photocopiers and personal computers, the Internet and the world wide web, all at a prices that bring them within the working domain of the smallest of companies, have eroded the "economies of size" beyond all recognition. Ongoing innovations in robotics and the Internet promise a further order of magnitude decline in the economics of mass production. This erosion of the logical basis and social rationale for the large corporation has gone largely unnoticed because of the lack of any vigorous alternative. This alternative will, I believe, ultimately emerge from the small business space.

As already discussed, a distinguishing characteristic of this space is that it is occupied by businesses that are privately rather than publicly owned. This gives to such businesses a motivational freedom disallowed the public corporation which is driven solely by the twin motives of profit and growth. This freedom in the small business space makes it possible to establish a motivational environment for employees vastly superior to anything that can be constructed in the large business space. Further, the close working relationships that connect owners with their employees can exploit further this enhanced motivational environment to produce employee productivities that are several times what can be realistically extracted from the large business space.

These advantages become increasingly significant as the disadvantages normally associated with an inability to extract economies of size are reduced or eliminated by technological progress. For these reasons, the trends in the economy strongly support an increasingly favorable competitive position for small businesses. Not only can the small business exploit these competitive advantages, but they also offer some additional potential advantages that are likely to prove of increasing social significance.

First, the improved motivational atmosphere and more intimate relationships plausible in a small business offer a psychological advantage to its employees, that extrapolated throughout society, means a happier and more productive work force. Second, an increasing number of small, local, specialized and highly skilled and motivated business concerns create opportunities to transfer the delivery of a variety of public services from an inefficient centralized bureaucracy to a locally controlled private sector. Finally, the burgeoning of both quality and quantity in the small business space will not only bring greater responsiveness and plurality to the marketplace but also greater employment stability. Small businesses cannot afford the draconian layoffs that characterize the large business response to a bottom line squeeze. All of these factors provide for greater stability in the economy and foster a healthy refocusing on local problem solving as a viable and hopeful alternative to the calamitous performance of large, centralized government. Thus the existence of both competitive reality and social desirability represent powerful evolutionary forces presaging a dramatic expansion of the small business space with an appropriate contraction of the importance and significance of the public corporation in shaping the economy. However, little of this is evident in current public perception. Totally missing is any social infrastructure which acknowledges this fact.

Private enterprise in the United States is symbolically connected into the large business space. The public corporations and the financial markets that are their exclusive servants dominate the public perception of the capitalist system. The business literature from *Forbes* and *Fortune* to the *Wall Street Journal* and the *Harvard Business Review* is almost entirely devoted to the investigation, analysis and/or reporting of what transpires in the large business space. Schools of business study the workings of large corporations and turn out students specifically trained for management in the large business space. The political process is focused exclusively on the social management of the large business space. Although frequent reference is made to the fact that a majority of new jobs created in the recent past are due to activities of smaller businesses, no one believes that such businesses are anything but a part of the spectrum at the other end

of which stand America's corporate giants. The institutional and therefore the public perception thus fails to recognize the truly distinctive nature of the small business space.

The result is an absence of any realistic private sector funding mechanism for enterprises destined for the small business space; an absence of any educational programs not modeled upon the corporate structures emanating from the large business space; an absence of any political awareness of the harm imposed on the small business space by the indiscriminate nature of business legislation and tax policies derived in response to the norms of the large business space.

The predictable expansion of the small business space must therefore be driven by an awareness from within. Those of us who populate this space must seek to understand its contours and fully exploit its opportunities. It behooves us to work together, initially to help create for ourselves the infrastructure that we need, and ultimately to explore the cooperative relationships that could make plausible the execution of business projects larger than any single occupant of the small business space could otherwise undertake.

By "professionalizing" our performance, properly setting our sails to maximize the advantage from the technological winds that are blowing so strongly in our favor, and extracting every possible advantage available from the small business space, we can place products in the marketplace at prices that will set the competitive standard. Small business "networks" can be established, organizations that bring small business people together for mutual exchanges of information, ideas, problems, and solutions. These will lead to the development of small business "cooperative" structures whereby small businesses will link together in imaginative ways to undertake desirable projects that exceed in scope the capabilities of any of the participants acting alone. By these means pressure can be placed on the large business sector, forcing large corporations out of the domains best serviced from the small business space. These large businesses will then be free to concentrate their skills on better developing commodity products whose low price can justify their own existence in the marketplace.

The Vermont Small Business Training Center is dedicated to the professionalizing of a new generation of small businesses, making them aware and proud to be a part of a newly recognized small business sector.