



Defining Small Business: An Historical Analysis of Contemporary Issues

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Summary

There is bipartisan agreement that the nation's small businesses play a key role in the American economy. However, there are differences of opinion concerning how to define them. This issue is of congressional interest because the definition used determines eligibility for Small Business Administration loan and consultative support assistance as well as federal contracting preferences and federal tax preferences.

The Small Business Act of 1953 (P.L. 83-163, as amended) authorized the Small Business Administration (SBA) and made it responsible for establishing size standards for determining eligibility for federal small business assistance. More than 50 years have passed since the SBA established its initial small business size standards in 1956. Yet, decisions made then concerning the rationale and criteria used to define small businesses established precedents that continue to shape current policy.

The SBA has based its size standards on economic analysis. However, in the absence of precise statutory guidance and consensus on how to define small, the SBA's size standards have often been challenged, typically by industry representatives advocating a broadening of the size standards to allow more firms in their industry to be eligible for assistance and by Members of Congress concerned that the size standards do not adequately target the SBA's assistance to firms that they consider to be truly small.

Over the years, the SBA has reviewed its size standards on an ad hoc basis for specific industries, typically because it had determined that market conditions in those classifications had changed. On five occasions, in 1980, 1982, 1992, 2004, and 2008, the SBA proposed a comprehensive revision of its size standards. None of these proposals was fully implemented, but the arguments presented, both for and against the proposals, provide a context for understanding the SBA's current size standards, and the rationale and criteria that have been presented to retain and replace them.

The SBA currently uses one of the following four criteria to determine program eligibility for firms in 1,159 industrial classifications described in the North American Industry Classification System (NAICS): (1) number of employees; (2) average annual receipts in the previous three years; (3) asset size; or (4) for electrical power industries, the extent of power generation.

The SBA's application of these criteria varies by industry. The SBA uses employment size to determine eligibility for manufacturing firms, most mining firms, and for firms in the wholesale trades industry. It uses average annual receipts to determine program eligibility for most other industrial classifications, asset size for six industrial classifications, and extent of power generation in megawatts for six others. Overall, the SBA currently classifies about 99.7% of all employer firms as small.

This report examines the competing views that have been presented concerning how to define a small business and how various proposals for changing the SBA's size standards would affect program eligibility.

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What is a Small Business?

There is bipartisan agreement that small businesses play a key role in the American economy. For example, the Senate Democratic Policy Committee asserts that “America’s ... small businesses serve as the engine of the American economy.”¹ The Senate Republican Policy Committee agrees, asserting that “Small businesses ... [are] the engines of growth in the American economy.”² President Barack Obama concurs, stating that

Small businesses are the heart of the American economy. They’re responsible for half of all private sector jobs—and they created roughly 70 percent of all new jobs in the past decade. So small businesses are not only job generators, they’re also at the heart of the American Dream. After all, these are businesses born in family meetings around kitchen tables. They’re born when a worker takes a chance on her desire to be her own boss. They’re born when a part-time inventor becomes a full-time entrepreneur, or when somebody sees a product that could be better or a service that could be smarter, and they think, “Well, why not me? Let me try it. Let me take my shot.”³

Although there is a general consensus that small businesses are important to the economy, there are differences of opinion concerning how to define them. This issue is of congressional interest because the definition used determines business eligibility for Small Business Administration (SBA) loan and consultative support assistance as well as federal contracting preferences and federal tax preferences for small businesses.

How Big is Small?

The SBA estimates that there were 29.6 million businesses in the United States in 2008, including 6.1 million employer firms and 23.1 million nonemployer firms.⁴ Nonemployer firms have no paid employees, annual business receipts of \$1,000 or more (\$1 or more in the construction industries), and are subject to federal income tax.⁵ Most nonemployers are self-employed individuals operating very small unincorporated businesses, which may or may not be the owner’s principal source of income. These firms are excluded from most business statistics.⁶

¹ Senate Democratic Policy Committee, “Senate Democrats Are Committed to America’s Small Businesses,” Washington, DC: Senate Democratic Policy Committee, May 18, 2009, http://sbc.senate.gov/DPC_small_biz_doc.pdf.

² Senate Republican Policy Committee, “Taxing Success: President Obama’s Tax Increases on Small Businesses are Bad for Job Creation,” Washington, DC: Senate Republican Policy Committee, March 17, 2009, http://rpc.senate.gov/public/_files/031709TaxingSuccess.pdf.

³ President Barack Obama, “Remarks by the President to Small Business Owners, Community Leaders and Members of Congress,” Press Release, Washington, DC, Office of the Press Secretary, March 16, 2009, http://www.whitehouse.gov/the_press_office/Remarks-by-the-President-to-small-business-owners/.

⁴ U.S. Small Business Administration, “The Small Business Economy: A Report to the President,” Washington, DC: GPO, 2009, p. 8. The latest actual counts are 6 million employer firms in 2006 and 21.7 million nonemployer firms in 2007. See U.S. Bureau of the Census, “Detailed Statistics: 2007 Nonemployer Statistics,” Washington, DC: U.S. Bureau of the Census, July 21, 2009, http://factfinder.census.gov/servlet/IBQTable?_bm=y&-ds_name=NS0700A1.

⁵ U.S. Bureau of the Census, “Nonemployer Statistics Definitions,” Washington, DC: U.S. Bureau of the Census, July 15, 2009, <http://www.census.gov/econ/nonemployer/definitions.htm>.

⁶ U.S. Bureau of the Census, “Nonemployer Statistics,” Washington, DC: U.S. Bureau of the Census, <http://www.census.gov/econ/nonemployer/>. Note: Nonemployer firms account for less than 4% of business activity in terms of annual sales or receipts.

As **Table 1** indicates, in 2006 (the latest available data), there were 6,022,127 employer firms in the United States employing 119,917,165 people and providing total payroll of \$4.79 trillion.

Table 1. Number of Employer Firms, Employer Firm Employment, and Employer Firm Annual Payroll, by Employer Firm Employment Size, 2006

Number of Employees	Number of Employer Firms	Cumulative Percentage of Total Number of Employer Firms	Employment	Cumulative Percentage of Employer Firm Total Employment	Employer Firm Annual Payroll (\$1,000)	Cumulative Percentage of Employer Firm Total Annual Payroll
0 ^a	794,622	13.2%	-	-	\$42,278,863	0.9%
1-4	2,875,935	61.0	5,959,585	5.0%	187,451,177	4.8
5-9	1,060,787	78.6	6,973,537	10.8	214,137,111	9.3
10 - 19	646,816	89.3	8,676,398	18.0	282,193,078	19.9
20-49	406,464	96.1	12,210,784	28.2	420,435,449	23.9
50-99	129,401	98.2	8,866,091	35.6	321,481,704	30.6
100-499	90,560	99.7	17,537,345	50.2	660,815,715	44.4
500-999	8,974	99.9	6,197,683	55.4	247,551,621	49.6
1,000-1,499	2,962	99.9	3,605,836	58.4	152,725,489	52.8
1,500 -2,499	2,374	99.9	4,537,676	62.2	195,499,433	56.9
2,500-4,999	1,877	99.9	6,479,030	67.6	304,377,206	63.2
5,000-9,999	931	99.9	6,490,547	73.0	302,709,162	69.5
10,000+	953	100.0	32,382,653	100.0	1,460,773,903	100.0
Total	6,022,127		119,917,165		4,792,429,911	

Source: U.S. Small Business Administration, Office of Advocacy, "Employer Firms, Establishments, Employment, and Annual Payroll Small Firm Size Classes, 2006," Washington, DC, http://www.sba.gov/advo/research/us_06ss.pdf.

- a. Employment is measured in March, thus some employer firms (start-ups after March, closures before March, and seasonal firms) will have zero employment and some annual payroll.

Most employer firms (61.0%) had fewer than five employees, 89.3% had fewer than 20 employees, 98.2% had fewer than 100 employees, and 99.7% had fewer than 500 employees. The table also provides data concerning three possible economic factors that might be used to define a small business: an employer firm's number of employees as a share (cumulative percentage) of the total number of employer firms, as a share of employer firm total employment, and as a share of employer firm total annual payroll.

As will be discussed, the SBA has traditionally applied economic factors to specific industries, not to cumulative statistics for all employer firms, to determine which firms are small businesses. Nonetheless, the data in **Table 1** illustrate how the selection of economic factors used to define small business affects the definition's outcome. For example, for illustrative purposes only, if the mid-point (50%) for these three economic factors was used to define what is a small business, three different employee firm sizes would be used to designate firms as small:

- Businesses would be required to have less than five employees to be defined as small if the definition for small used the mid-point (50%) share of the total number of employer firms (employer firms with less than five employees accounted for 61% of the total number of employer firms in 2006).
- Businesses would be required to have less than 500 employees to be defined as small if the definition for small used the mid-point (50%) share of employer firm total employment (employer firms with less than 500 employees accounted for 50.2% of employer firm total employment in 2006).
- Businesses would be required to have less than 1,500 employees to be defined as small if the definition for small used the mid-point (50%) share of employer firm total annual payroll (employer firms with less than 1,500 employees accounted for 52.8% of employer firm total annual payroll in 2006).

Other economic factors that might be used to define a small business include the value of the employer firm's assets or its market share, expressed as a firm's sales revenue from that market divided by the total sales revenue available in that market or as a firm's unit sales volume in that market divided by the total volume of units sold in that market.

Who Makes the Call?

The Small Business Act of 1953 (P.L. 83-163, as amended) authorized the SBA and made it responsible for establishing size standards for determining eligibility for small business assistance. More than 50 years have passed since the SBA established its initial small business size standards in 1956. Yet, decisions made then concerning the rationale and criteria used to define small businesses established precedents that continue to shape current policy. Moreover, as will be shown, since its beginnings the SBA has based its size standards on economic analysis. However, in the absence of precise statutory guidance and consensus on how to define small, the SBA's size standards have often been challenged, typically by industry representatives advocating a broadening of the size standards to allow more firms in their industry to be eligible for assistance and by Members of Congress concerned that the size standards do not adequately target the SBA's assistance to firms that they consider to be truly small.

Over the years, the SBA has typically reviewed its size standards piecemeal, reviewing specific industries when the SBA determined that an industry's market conditions had changed or the SBA was asked to undertake a review by an industry claiming that its market conditions had changed. On five occasions, in 1980, 1982, 1992, 2004, and 2008, the SBA proposed a comprehensive revision of its size standards. None of these proposals was fully implemented, but the arguments presented, both for and against the proposals, provide a context for understanding the SBA's current size standards, and the rationale and criteria that have been presented to retain and replace them.

Early Definitions of Small Business Vary in Approach and Criteria

Today, there is no uniform or accepted definition for a small business. Instead, several criteria are used to determine eligibility for small business spending and tax programs.⁷ This was also the case when Congress considered establishing the SBA during the early 1950s. For example, in 1952, the House Select Committee on Small Business reviewed federal statutes, executive branch directives, and the academic literature to serve as a guide for determining how to define small businesses.

The Select Committee began its review by asserting that the need to define the concept of small business was based on a general consensus that assisting small business was necessary to enhance economic competition, combat monopoly formation, inhibit the concentration of economic power, and maintain “the integrity of independent enterprise.”⁸ It noted that the definition of small businesses in federal statutes reflected this consensus by taking into consideration the firm’s size relative to other firms in its field and “matters of independence and nondominance.”⁹ For example, the War Mobilization and Reconversion Act of 1944 defined a small business as either “employing 250 wage earners or less” or having “sales volumes, quantities of materials consumed, capital investments, or any other criteria which are reasonably attributable to small plants rather than medium- or large-sized plants.”¹⁰ The Selective Service Act of 1948 classified a business as small for military procurement purposes if “(1) its position in the trade or industry of which it is a part is not dominant, (2) the number of its employees does not exceed 500, and (3) it is independently owned and operated.”¹¹

The Select Committee also found that, for data-gathering purposes, the executive branch defined small businesses in relative, as opposed to absolute, terms within specific industries. For example, the Bureau of Labor Statistics “defined small business in terms of an average for each industry based on the volume of employment or sales. All firms which fall below this average are deemed to be small.”¹² The Bureau of the Census also used different criteria for different industries. For example, manufacturing firms were classified as small if they had fewer than 100 employees, wholesalers were considered small if they had annual sales below \$200,000, and retailers were considered small if they had annual sales below \$50,000. According the Bureau of the Census, in

⁷ According to one source, the Internal Revenue Code contains at least 24 different definitions of a small business. See Douglas K Barney, Chris Bjornson, and Steve Wells, “Just How Small Is Your Business?,” *The National Public Accountant*, August 2003, pp. 4-6, <http://www.entrepreneur.com/tradejournals/article/107492826.html>, cited in CRS Report RL32254, *Small Business Tax Benefits: Overview and Economic Rationale*, by Gary Guenther.

⁸ U.S. Congress, House Select Committee on Small Business, *Review of Small Business: 82nd Congress*, final report pursuant to H.Res. 33, A Resolution Creating a Select Committee to Conduct a Study and Investigation of the Problems of Small Business, 82nd Cong., 2nd sess., December 31, 1952 (Washington: GPO, 1952), pp. 5, 13, 14, 78, and 136.

⁹ *Ibid.*, p. 3.

¹⁰ *Ibid.*, p. 2.

¹¹ *Ibid.*; and U.S. Congress, Conference Committee, *Selective Service Act of 1948*, conference report no. 2438, 80th Cong., 2nd sess., June 19, 1948 (Washington: GPO, 1948), p. 24.

¹² U.S. Congress, House Select Committee on Small Business, *Review of Small Business: 82nd Congress*, final report pursuant to H.Res. 33, A Resolution Creating a Select Committee to Conduct a Study and Investigation of the Problems of Small Business, 82nd Cong., 2nd sess., December 31, 1952 (Washington: GPO, 1952), p. 3.

1952, small businesses accounted for “roughly 92 percent of all business establishments, 45 percent of all employees, and 34 percent of all dollar value of all sales.”¹³

The Select Committee also noted that in 1951, the National Production Authority’s Office of Small Business proposed defining all manufacturing firms with less than 50 employees as small and any with more than 2,500 employees as large. Manufacturers employing between these numbers of employees would be considered large or small depending on the general structure of the industry to which they belonged. The larger the percentage of total output produced by large firms, the larger the number of employees a firm could have to be considered small. Using this definition, most manufacturing firms with less than 50 employees would be classified as small, but others, such as an aircraft manufacturer, could have as many as 2,500 employees and still be considered small.¹⁴

For procurement purposes, the Select Committee found that executive branch agencies defined small businesses in absolute, as opposed to relative, terms, using 500 employees as the dividing line between large and small firms. Federal agencies defended the so-called 500 employee rule on the grounds that it “had the advantage of easy administration” across federal agencies.¹⁵

In reviewing the academic literature, the Select Committee reported that Abraham Kaplan’s *Small Business: Its Place and Problems* defined small businesses as those with no more than \$1 million in annual sales, \$100,000 in total assets, and no more than 250 employees. Applying this definition would have classified about 95% of all business concerns as small, and would have accounted for about half of all nonagricultural employees.¹⁶

Based on its review of federal statutes, executive branch directives, and the academic literature, the Select Committee decided that it would not attempt “to formulate a rigid definition of small business” because “the concept of small business must remain flexible and adaptable to the peculiar needs of each instance in which a definition may be required.”¹⁷ However, it concluded that the definition of *small* should be a relative one, as opposed to an absolute one, that took into consideration variations among economic sectors:

This committee is also convinced that whatever limits may be established to the category of small business, they must vary from industry to industry according to the general industrial pattern of each. Public policy may demand similar treatment for a firm of 2,500 employees in one industry as it does for a firm of 50 employees in another industry. Each may be faced with the same basic problems of economic survival.¹⁸

¹³ Ibid., p. 3.

¹⁴ Ibid., p. 4.

¹⁵ U.S. Congress, House Select Committee on Small Business, Subcommittee No. 2, *Definition of “Small Business” Within Meaning of the Small Business Act of 1953, as Amended*, hearing on H.Res. 114, 84th Cong., 2nd sess., July 5, 1956 (Washington: GPO, 1956), p. 19.

¹⁶ U.S. Congress, House Select Committee on Small Business, *Review of Small Business: 82nd Congress*, final report pursuant to H. Res. 33, A Resolution Creating a Select Committee to Conduct a Study and Investigation of the Problems of Small Business, 82nd Cong., 2nd sess., December 31, 1952 (Washington: GPO, 1952), p. 4. See, Abraham David Hannath Kaplan, *Small Business: Its Place and Problems* (NY: McGraw-Hill Book Co., 1948), pp. 21, 22.

¹⁷ U.S. Congress, House Select Committee on Small Business, *Review of Small Business: 82nd Congress*, final report pursuant to H.Res. 33, A Resolution Creating a Select Committee to Conduct a Study and Investigation of the Problems of Small Business, 82nd Cong., 2nd sess., December 31, 1952 (Washington: GPO, 1952), p. 4.

¹⁸ Ibid., p. 5.

The Small Business Act of 1953's Definition of Small Provides Room for Interpretation

Reflecting the view that formulating a rigid definition of small business was impractical, the Small Business Act of 1953 provided leeway in defining small businesses. It defined a small firm as “one that is independently owned and operated and which is not dominant in its field of operation.”¹⁹ The SBA was provided authority to establish and subsequently alter size standards for determining eligibility for federal programs to assist small business, some of which are administered by the SBA.²⁰ The act specifies that the size standards “may utilize number of employees, dollar volume of business, net worth, net income, a combination thereof, or other appropriate factors.”²¹ It also notes that the concept of small is to be defined in a relative sense, varying from industry to industry to the extent necessary to reflect “differing characteristics” among industries.²²

The House Committee on Banking and Currency's report accompanying H.R. 5141, the Small Business Act of 1953, issued on May 28, 1953, provided the committee's rationale for not providing a detailed definition of small: “It would be impractical to include in the act a detailed definition of small business because of the variation between business groups. It is for this reason that the act authorizes the Administration to determine within any industry the concerns which are to be designated small-business concerns for the purposes of the act.”²³ The report did not provide specific guidance concerning what the committee might consider to be small, but it did indicate that data on industry employment, as of March 31, 1948, “reveals that on the basis of employment, small business truly is small in size. Of the approximately 4 million business concerns, 87.4% had under 8 employees and 95.2% of the total number of concerns, employed less than 20 people.”²⁴

Industry Challenges the SBA's Initial Size Standards, Claiming They Are Too Restrictive

Initially, the SBA created two sets of size standards, one for federal procurement preference and set-aside programs and another for the SBA's loan and consultative support services. At the request of federal agencies, the SBA adopted the then-prevailing small business size standard used by federal agencies for procurement, which was 500 or fewer employees. The SBA retained

¹⁹ 15 U.S.C. § 632(a)(1).

²⁰ Initially, the SBA size standards applied only to its own programs. Other federal agencies used the SBA size standards for procurement purposes on a voluntary basis. The Regulatory Flexibility Act of 1980 directed federal agencies to use SBA size standards or establish their own definitions after conferring directly with the SBA's Bureau (now Office) for Advocacy. U.S. Congress, Senate Committee on Small Business, *Small Business Administration's Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 18. Also, see 5 U.S.C. § 601(3).

²¹ 15 U.S.C. § 632(a)(2).

²² 15 U.S.C. § 632(a)(3).

²³ U.S. Congress, House Committee on Banking and Currency, *Small Business Act of 1953*, report to accompany H.R. 5141, 83rd Cong., 1st sess., May 28, 1953, H.Rept. 83-494 (Washington: GPO, 1953), p. 3.

²⁴ *Ibid.*, p. 4.

the right to make exceptions to the 500 or fewer employee procurement size standard if the SBA determined that a firm having more than 500 employees was not dominant in its industry.

For the SBA's loan and consultative support services, the SBA's staff reviewed economic data provided by the Bureau of the Census to arrive at what Wendell Barnes, SBA's Administrator, described at a congressional hearing in 1956 as "a fairly accurate conclusion as to what comprises small business in each industry."²⁵ Jules Abels, SBA's Economic Advisor to the Administrator, explained at that congressional hearing how the SBA's staff determined what constituted a small business:

There are various techniques for the demarcation lines, but in a study of almost any industry, you will find a large cluster of small concerns around a certain figure.... On the other hand, above a certain dividing line you will find relatively few and as you map out a picture of an industry it appears that a dividing line at a certain point is fair.²⁶

On January 5, 1956, a notice of proposed rulemaking was published in the *Federal Register* listing the SBA's proposed small business size standards for its loan and consultative support services. During the public comment period, representatives of several industries argued that the proposed standards were too restrictive and excluded too many firms. In response, Mr. Abels testified that the SBA decided to adjust its figures to make them "a little bit more liberal because there was some feeling on the part of certain industries that they were too tight and that they excluded too many firms."²⁷ SBA's small business size standards became effective on October 1, 1956.

The SBA decided to use number of employees as the sole criteria for determining if manufacturing firms were small and annual sales or annual receipts as the sole criteria for all other industries. Mr. Abels explained at the congressional hearing the SBA's rationale for using number of employees for classifying manufacturing firms as small and annual sales or annual receipts for all other firms:

in the absence of automation which would give one firm in an industry a great advantage over another, roughly speaking if the firms were mechanized to the same extent, a firm with 400 employees would have an output which would be twice as large as the output of a firm with 200 employees.... However when you depart from the manufacturing field and go into, say, a distributive field or trade, it then becomes necessary to discard the number of employees, because it is a matter of judicial notice, that one man for example in the distributive trades can sell as much as 100 men can sell. One small construction firm possibly can do a lot more business than one with a lot more employees. A service trade again has its volume geared to something other than the number of employees. So I think that one can say with reasonable certainty that it is only within the manufacturing field that the employee standard is the uniform yardstick, but that other than manufacturing the dollar volume is the appropriate yardstick.²⁸

²⁵ U.S. Congress, House Select Committee on Small Business, Subcommittee No. 2, *Definition of "Small Business" Within Meaning of the Small Business Act of 1953, as Amended*, hearing on H. Res. 114, 84th Cong., 2nd sess., July 5, 1956 (Washington: GPO, 1956), p. 24.

²⁶ *Ibid.*, p. 39.

²⁷ *Ibid.*, p. 40.

²⁸ *Ibid.*, p. 41.

The SBA's initial size standards defined manufacturing firms employing 250 or fewer employees as small. In addition, the SBA considered manufacturing firms in some industrial classifications (e.g., metalworking and small arms) as small if they employed 500 or fewer employees, and in some other industrial classifications (e.g., sugar refining and tractors) as small if they employed 1,000 or fewer employees. To be considered small, wholesalers were required to have annual sales volume of \$5 million or less; construction firms had to have average annual receipts of \$5 million or less over the preceding three years; trucking and warehousing firms had to have annual receipts of \$2 million or less; taxicab companies and most firms in the service trades had to have annual receipts of \$1 million or less; and most retail firms had to have annual sales of \$1 million or less.²⁹

Mr. Ables testified that the SBA experienced "continual" protests of its size standards by firms denied financial or support assistance because they were not considered small. He also testified that in each case, the SBA denied the protest and determined, in his words, that the standard was "valid and accurate."³⁰

The SBA also experienced some opposition to its decision to adopt the then-prevailing 500 or fewer employee size standard for all industries for federal procurement preference and set-aside programs. For example, Irvin Maness, Subcommittee Counsel for the Select Committee on Small Business Subcommittee No. 2, argued during a congressional oversight hearing in 1956 that the SBA's use of the so-called rule of 500 employees as the size standard for procurement violated congressional intent, which he argued was to have a definition for small business that varied "on an industry-to-industry basis."³¹ Several Members also objected to the possibility that some firms could be considered small for procurement purposes, but not for the SBA's loan and consultative support services.

GAO and Several Members of Congress Challenge the SBA's Size Standards, Claiming They Are Too Broad

In 1977, the U.S. General Accounting Office (GAO, now the U.S. Government Accountability Office) was asked by the Select Committee on Small Business to review the SBA's size standards. At that time, most of SBA's size standards remained at their original 1956 levels, other than a one-time upward adjustment for inflation in 1975 for industrial classifications using annual sales and receipts to restore eligibility to firms that may have lost small-business status due solely to the effect of inflation.³²

²⁹ Ibid., p. 3. Note: In the retail sector, department and variety stores, grocery stores with fresh meats, and new and used automobile stores were considered small if they had annual sales volume of \$2 million or less. In the service trades sector, hotels and power industry firms were considered small if they had annual receipts of \$2 million or less.

³⁰ Ibid., p. 40.

³¹ Ibid., pp. 33, 43.

³² U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 3. Notes: GAO reported that adjustments to the size standards had been made to "only 81 of the 534 industries covered by the special standards" from January 1, 1968 through April 25, 1978. The upward inflation adjustments for industrial (continued...)

GAO's report, issued in 1978, noted that the SBA's regulations indicated that the SBA used the following factors in formulating its size standards:

- “because the purpose of SBA assistance is to preserve free competitive enterprise by strengthening the competitive position of small business concerns, the size standards should be limited to the segment of each industry that is struggling to become or remain competitive;
- because smaller concerns often are forced to compete with middle-sized as compared with very large concerns, the standard for each industry should be established as low as reasonably possible; and
- small businesses should not rely on continuing assistance but should plan for the day when they will be able to compete without assistance.”³³

After conducting its analysis, GAO concluded that the SBA's size standards “are often high and often are not justified by economic rationale.”³⁴ Specifically, GAO reported that

many size standards may not direct assistance to the target group described in SBA regulations as businesses “struggling to become or remain competitive” because the loan and procurement size standards for most industries were established 15 or more years ago and have not been periodically reviewed; SBA records do not indicate how most standards were developed; and the standards often define as small a very high percentage of the firms in the industries to which they apply.³⁵

GAO recommended that the SBA reexamine its size standards “by collecting data on the size of bidders on set-aside and unrestricted contracts, determining the size of businesses which need set-aside protection because they cannot otherwise obtain Federal contracts” and then consider reducing its size standards or “establishing a two-tiered system for set-aside contracts, under which certain procurements would be available for bidding only to the smaller firms and others would be opened for bidding to all businesses considered small under present standards.”³⁶

Citing the GAO report, several Members objected to the SBA's size standards at a House Committee on Small Business oversight hearing conducted on July 10, 1979. Representative John J. LaFalce (D-NY), chair of the House Committee on Small Business Subcommittee on General Oversight and Minority Enterprise, stated that “What we have faced from 1953 to the present is virtually nothing other than acquiescence to the demands of the special interest groups. That is how the size standards have been set.”³⁷ Representative Tim Lee Carter (R-KY), the Subcommittee's ranking minority Member, stated that “it seems to me that we may be fast

(...continued)

classifications using annual sales or receipts ranged from 10.3% to 92.9% depending on the date when the standards were adopted. See, U.S. Small Business Administration, “Small Business Size Standards,” 40 *Federal Register* 24210-24215, June 5, 1975, and U.S. Small Business Administration, “Small Business Size Standards Regulation,” 40 *Federal Register* 32824-32826, August 5, 1975.

³³ U.S. General Accounting Office, *What Is A Small Business? The Small Business Administration Needs To Reexamine Its Answer*, CED-78-149, August 9, 1978, pp. 1, 2, <http://archive.gao.gov/f0902d/106766.pdf>.

³⁴ *Ibid.*, p. 3.

³⁵ *Ibid.*

³⁶ *Ibid.*, p. 20.

³⁷ U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 9.

growing into just a regular bank forum not just to small business but to all business.”³⁸ At that time, approximately 99% of all firms with employees were classified by the SBA as a small business.³⁹

Roger Rosenberger, SBA’s Associate Administrator for Policy, Planning and Budgeting, testified at the hearing that the SBA would undertake a comprehensive economic analysis of industry data to determine if its size standards should be changed. However, he also defended the validity of the SBA’s size standards, arguing that the task of setting size standards was a complicated and difficult one because of “how market structure and size distribution of firms vary from industry to industry.”⁴⁰ He testified that some industries are dominated by a few large firms, some are comprised almost entirely of small businesses, and others “can be referred to as a mixed industry.”⁴¹ He argued that each market structure presents unique challenges for defining small businesses within that industry group. For example, he argued that it was debatable whether the SBA should provide any assistance to any of the businesses within industries where “smaller firms are flourishing.”⁴² He added that

We have no problem identifying either the very small firms or the large firms, in any given industry. Our problem is with that gray area—the so-called mid-sized firm. Should the mid-sized firm be included or excluded based on the competitive aspects of the market? Should we assist competition in an industry by aiding the mid-sized firms, since they probably represent the only major competitive force vis-a-vis the dominant companies given that these firms may also compete with the very small firms?⁴³

SBA Proposes More Restrictive Size Standards Based on Industry Competitiveness

On March 10, 1980, the SBA issued a notice of proposed rulemaking for “a substantial revision of its size standards.”⁴⁴ In an effort to “simplify SBA programs for the small business community, reduce administrative complexity, and increase the effectiveness of SBA programs by improved targeting of its resources,” the SBA proposed to replace its two sets of size standards, one for procurement preference and set-aside programs and another for its loan and consultative support services, with a single set of size standards for both purposes.⁴⁵

The SBA also proposed to use a single factor, the firm’s number of employees, for definitional purposes for nearly all industrial classifications instead of using the firm’s number of employees

³⁸ Ibid., p. 6.

³⁹ U.S. Congress, Senate Committee on Small Business, *Small Business Administration’s Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 14.

⁴⁰ U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 17.

⁴¹ Ibid.

⁴² Ibid., p. 28.

⁴³ Ibid.

⁴⁴ U.S. Congress, House Committee on Small Business, *Small Business Size Standards*, hearing, 96th Cong., 2nd sess., March 13, 1980 (Washington: GPO, 1980), p. III.

⁴⁵ Ibid., p. 49.

for some industrial classifications, the firm's assets for others, and the firm's annual gross receipts for still others. The SBA argued that "when size standards are denominated in dollars, i.e., annual revenues, its ability to help the small business sector is undermined by inflation. Using employment, as opposed to dollar sales, will provide greater stability for SBA and its clients; will remove inter-industry distortions generated by differential inflation rates; and reduce the need for SBA to make frequent revisions in the size standards merely to reflect price increases."⁴⁶

In setting its proposed new size standards for each industrial classification (ranging from 15 or fewer employees to 2,500 or fewer employees), the SBA first placed each industrial classification into one of three groups: concentrated, competitive, or mixed. Concentrated industries are "characterized by a highly unequal distribution of sales among the firms in the industry, e.g., the four largest firms accounting for more than half the industry's sales."⁴⁷ Competitive industries "display a more equal distribution of sales, and the average firm is relatively small when measured by annual sales or number of employees."⁴⁸ In competitive industries, the four largest firms typically account for less than 20% of industry sales. Mixed industries do not "meet the criteria of competitive or concentrated industries."⁴⁹ In mixed industries, the four largest firms typically account for 20% to 50% of industry sales.⁵⁰

The SBA determined that there were 160 concentrated industries, 317 competitive industries, and 249 mixed industries.⁵¹ The SBA argued that establishing a size standard for the 160 concentrated industries was a "straight-forward task—simply identify and exclude those few firms which account for a disproportionately large share of the industry's sales."⁵² For competitive industries, the SBA argued that the size standard should be set "relatively low, so as to support entry and moderate growth."⁵³ The SBA argued that mixed industries require "relatively high size standards ... to reinforce competition and offset the pressures to increase the degree of concentration in these industries."⁵⁴

The proposed new SBA size standards would have had the net effect of reducing the number of firms classified as small by about 225,000.⁵⁵ In percentage terms, the number of firms classified as small would have been reduced from about 99% of all employer firms to 96%.⁵⁶

Over 86% of the more than 1,500 public comments received by the SBA concerning its proposed new size standards criticized the proposal. Most of the criticism was from firms that would no

⁴⁶ Ibid., p. 50.

⁴⁷ Ibid., p. 48.

⁴⁸ Ibid.

⁴⁹ Ibid.

⁵⁰ U.S. Congress, Senate Committee on Small Business, *Small Business Administration's Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 19.

⁵¹ U.S. Congress, House Committee on Small Business, *Small Business Size Standards*, hearing, 96th Cong., 2nd sess., March 13, 1980 (Washington: GPO, 1980), p. 48.

⁵² Ibid., p. 49.

⁵³ Ibid.

⁵⁴ Ibid.

⁵⁵ U.S. Congress, Senate Committee on Small Business, *Small Business Administration's Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 11.

⁵⁶ Ibid., p. 25.

longer be considered small under the new size standards.⁵⁷ In addition, several federal agencies indicated that the proposed size standards in the services and construction industries were set too low, reducing the number of small firms eligible to compete for procurement contracts below levels they deemed necessary to ensure adequate competition to prevent agency costs from rising. They also argued that the proposed size standards would reduce the number of firms eligible to compete for procurement contracts that are “sufficiently large to perform the majority of [procurement] set-aside programs.”⁵⁸ For example, the Department of Defense argued that “the small business firms must have the infrastructure both capitalwise and employewise to compete in this particular area. They cannot be ‘Mom and Pop Shops’ which some of the proposed size standards [would require].”⁵⁹ It also argued that in the services area “the receipt of the very first contract would automatically make many small business firms large business. We think that is wrong.”⁶⁰

On October 21, 1980, Congress provided additional time to consider the consequences of the proposed changes to the size standards by adopting the Small Business Export Expansion Act of 1980 (P.L. 96-481). It prohibited “the SBA from promulgating any final rule or regulation relating to small business size standards until March 31, 1981.”⁶¹ In the meantime, the Reagan Administration entered office, and, as is customary when there is a change in Administration, replaced the SBA’s senior leadership.

The SBA’s new Administrator, Michael Cardenas, praised the previous (Carter) Administration’s efforts to (1) apply a comprehensive rationale (based on industry competitiveness), as opposed to a piecemeal approach, for determining the SBA size standards; (2) adopt a single size standard as a means to prevent the possibility of firms qualifying for procurement preferences, but not for the SBA’s loan and consultative support services; and (3) increase the reliance on the firm’s number of employees, as opposed to its annual sales and receipts, for most industrial classifications as a means to avoid having to update the size standards to reflect inflation.⁶² However, he was sympathetic to the concerns of federal agencies that the proposed size standards in the services and construction industries were set too low to meet those agencies’ procurement needs. As a result, he indicated that the SBA would modify its size standards proposal by increasing the proposed size standards for 51 industries, mostly in the services and construction industries. He also indicated that the proposed size standards in 157 manufacturing industries would be lowered (typically from 2,500 or fewer employees to 500 or fewer employees) to prevent one or more of the largest producers in those industries from being classified as small. He also increased the SBA’s proposed lowest size standard from 15 or fewer employees to 25 or fewer employees. This change would have affected 93 service and trade industries. He testified on May 5, 1981, before the Senate Committee on Small Business, that these changes

have the net effect of restoring approximately 60,000 firms to eligibility out of a total of 225,000 firms (including farms) that had been removed from eligibility in the advance notice. Since the SBA estimates that there are at present a total of 7.3 million firms in the

⁵⁷ Ibid., pp. 4, 10, 16.

⁵⁸ Ibid., pp. 21, 43.

⁵⁹ Ibid., p. 43.

⁶⁰ Ibid., p. 44.

⁶¹ Ibid., p. 5; and P.L. 96-481.

⁶² U.S. Congress, Senate Committee on Small Business, *Small Business Administration’s Size Standards*, hearing, 97th Cong., 1st sess., May 5, 1981 (Washington: GPO, 1981), p. 12.

United States (based on Bureau of the Census data), the proposed changes actually impact on only a small proportion of firms in the economy.⁶³

The SBA did not formally issue a notice of proposed rulemaking concerning its new size standards proposal. Instead, for more than a year, it met with various trade organizations and federal agency procurement officials to discuss the proposal. As these consultations took place, the SBA experienced turnover in its senior leadership.

The SBA, headed by the new appointee, James C. Sanders, issued a notice of proposed rulemaking concerning its size standards on May 3, 1982. Mr. Sanders testified before the House Committee on Small Business Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, on October 20, 1983, that the SBA's May 3, 1982, proposed notice of rulemaking differed from its March 10, 1980, predecessor in three important ways:

First, the range of size standards was narrowed to a range of 25 employees to 500 employees. This reflected a widespread view that 15 employees was too low a cutoff while 2,500 employees was too high. Second, SBA proposed a 500-employee ceiling, focusing on smaller firms. Third, SBA responded to sentiments within many procurement-sensitive industries that the proposed size standards in some cases were too low to accommodate the average procurement currently being performed by small business. Therefore, SBA proposed higher size standards in a number of procurement-sensitive industries, while maintaining the 500-employee cap.⁶⁴

He also testified that the SBA received about 500 comments on the proposed rule, with about 72 percent of those comments opposing the rule.⁶⁵

Taking those comments into consideration, the SBA reexamined its size standards once again, and, after a year of further consultation with various trade organizations and federal agency procurement officials, issued another notice of proposed rulemaking on May 6, 1983. The 1983 proposal replaced the use of two sets of size standards, one for procurement and another for the SBA's loan and consultative support services, with a single set for all programs; retained most of the size standards that were expressed in terms of average annual sales or receipts; adjusted those size standards for inflation (an upward adjustment of 81%); retained most of the size standards for manufacturing, and made relatively minor changes to the size standards in other industrial classifications, with a continued emphasis on a 500-employee ceiling for most industries. The SBA received 630 comments on the proposed rule, with almost 70% supporting it.⁶⁶

⁶³ *Ibid.*, p. 11.

⁶⁴ U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, *Size Standards*, hearing, 98th Cong., 1st sess., October 20, 1983 (Washington: GPO, 1983), p. 17. Note: Congress created the Small Business Investment Company (SBIC) program in 1958 to provide small businesses enhanced access to equity capital, long-term loans, and consultative management assistance.

⁶⁵ U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, *H.R. 1178: Small Business Size Standards*, hearing, 99th Cong., 1st sess., July 30, 1985 (Washington: GPO, 1985), p. 198.

⁶⁶ U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, *Size Standards*, hearing, 98th Cong., 1st sess., October 20, 1983 (Washington: GPO, 1983), p. 18.

SBA Administrator Sanders characterized the SBA's revised size standard proposal as "a fine-tuning of current standards which has the basic support of both the private sector and the Federal agencies that use the basic size standards to achieve their set-aside procurement goals."⁶⁷ He also added that "since almost no size standard is proposed to decrease, and most will in fact increase, very few firms will lose their small business status. We estimate that about 39,000 firms will gain small business status."⁶⁸ He testified that in percentage terms, in 1983, 97.9% of the nation's 5.2 million firms with employees were classified by the SBA as small. Under the SBA's proposal, 98.6% of all firms with employees would be classified as small.⁶⁹ The final rule was published in the *Federal Register* on February 9, 1984.⁷⁰

Representative Parren J. Mitchell (D-MD), chair of the House Committee on Small Business, expressed disappointment in the SBA's final rule, stating at a congressional oversight hearing on July 30, 1985, that "the government and the business community are still victimized by that same ad hoc, sporadic system that the SBA promised to fix some six years ago."⁷¹ He introduced legislation (H.R. 1178, a bill to amend the Small Business Act) that would have required the SBA to adjust its size standard for an industrial classification downward by at least 20% if small business' share of that market equaled or exceeded 60%, and at least 40% of the market share was achieved through the receipt of federal procurement contracts. The bill also mandated a minimum 10% increase in the SBA's size standard for an industrial classification if small business' share of that market was less than 20% and less than 10% of the market share was achieved through the receipt of federal procurement contracts.⁷² The bill was opposed by various trade associations, the SBA, and federal agency procurement officials, and was not reported out of committee.⁷³

SBA Proposes to Streamline its Size Standards

In 1992, the SBA used 30 different size standards (e.g., 100 or fewer employees, 500 or fewer employees, 1,000 or fewer employees, \$5 million in average annual receipts) when classifying firms as small. On December 31, 1992, the SBA issued a notice of proposed rulemaking that was designed "to streamline its size standards by reducing the number of fixed size standard levels to nine."⁷⁴ The nine proposed size standards were: 100 or fewer, 500 or fewer, 750 or fewer, 1,000 or fewer, or 1,500 or fewer employees; and no more than \$5 million, \$10 million, \$18 million, or \$24 million in annual receipts. The annual receipts levels reflected an upward adjustment of 43% for inflation. The SBA argued that the "current system of 30 size standard levels has led to confusion and has created a needless complication of the size standards."⁷⁵ The SBA claimed that proposed changes to the size standards would make them more user-friendly for small business

⁶⁷ Ibid.

⁶⁸ Ibid.

⁶⁹ Ibid.

⁷⁰ Ibid.

⁷¹ U.S. Congress, House Committee on Small Business, Subcommittee on SBA and SBIC Authority, Minority Enterprise and General Small Business Problems, *H.R. 1178: Small Business Size Standards*, hearing, 99th Cong., 1st sess., July 30, 1985 (Washington: GPO, 1985), p. 4.

⁷² Ibid., pp. 237-250.

⁷³ Ibid., pp. 6, 8, 53, 153, 181, 244, 245, 261.

⁷⁴ ⁷⁴ U.S. Small Business Administration, "Small Business Size Standards: Fixed Size Standard Levels," *57 Federal Register* 62515, December 31, 1992.

⁷⁵ Ibid.

owners. It would also restore eligibility to nearly 20,000 firms that were no longer considered small solely because of the effects of inflation. The proposed rule was later withdrawn as a courtesy to allow the incoming Clinton Administration time to review the proposal.⁷⁶ The SBA ultimately decided not to pursue this approach because it felt that converting “receipts-based size standards in effect at that time to one of four proposed receipts levels created a number of unacceptable anomalies.”⁷⁷

Over the subsequent decade, the SBA reviewed the size standards for some industries on a piecemeal basis and, in 1994, adjusted for inflation its size standards based on firm’s annual sales or receipts (an upward adjustment of 48.2%). The SBA estimated that the adjustment would restore eligibility to approximately 20,000 firms that lost small-business status due solely to the effects of inflation.⁷⁸

In 2002, the SBA adjusted for inflation its annual sales- and receipts-based size standards for the fourth time (an upward adjustment of 15.8%). The SBA estimated that the adjustment would restore eligibility to approximately 8,760 firms that lost small-business status due solely to the effects of inflation. The rule also included a provision that the SBA would assess the impact of inflation on its annual sales- and receipts-based size standards at least once every five years.⁷⁹ Then, on March 19, 2004, the SBA, once again, issued a notice of proposed rulemaking in the *Federal Register* to streamline its size standards.⁸⁰

The proposed rule would have established size standards based on the firm’s number of employees for all industrial classifications, avoiding the need to adjust for inflation size standards based on sales or receipts.⁸¹ At that time, the SBA size standards consisted of 37 different size levels which applied to 1,151 industries and 13 sub-industry activities in the North American Industry Classification System. Thirty size standards were based on annual sales or receipts, five on number of employees (both full- and part-time), one on financial assets, and one on generating capacity. Under the proposed rule, the SBA would use 10 size standards, five new employee size standards (adding 50 or fewer, 150 or fewer, 200 or fewer, 300 or fewer, and 400 or fewer employees) and the existing five employee size standards (100 or fewer, 500 or fewer, 750 or fewer, 1,000 or fewer, and 1,500 or fewer employees).⁸²

The proposed rule would not have changed any of the size standards that were already based on number of employees. It would have converted size standards based on receipts, sales, assets, or generating capacity to an employee-based size standard. The SBA argued that the use of a single size standard would “help to simplify size standards” and “tends to be a more stable measure of

⁷⁶ U.S. Congress, House Committee on Small Business, Subcommittee on Minority Enterprise, Finance, and Urban Development, *SBA’s Efforts to Streamline Size Standards*, hearing, 103rd Cong., 1st sess., May 25, 1993 (Washington: GPO, 1993), pp. 5, 6.

⁷⁷ U.S. Small Business Administration, “Small Business Size Standards: Restructuring of Size Standards,” 69 *Federal Register* 13130, March 19, 2004.

⁷⁸ U.S. Small Business Administration, “Small Business Size Standards: Inflation Adjusted Size Standards,” 59 *Federal Register* 16513-16538, April 7, 1994.

⁷⁹ U.S. Small Business Administration, “Small Business Size Standards: Inflation Adjustment to Size Standards,” 67 *Federal Register* 65285-65290, October 24, 2002.

⁸⁰ U.S. Small Business Administration, “Small Business Size Standards: Restructuring of Size Standards,” 69 *Federal Register* 13129-13164, March 19, 2004.

⁸¹ *Ibid.*

⁸² *Ibid.*, p. 13130.

business size” than other measures.⁸³ It added that the proposed rule would change 514 size standards and that, after the proposed conversion to the use of number of employees, of the “approximately 4.4 million businesses in the industries with revised size standards, 35,200 businesses could gain and 34,100 could lose small business eligibility, with the net effect of 1,100 additional businesses defined as small.”⁸⁴

The SBA received more than 4,500 comments on the proposed rule, with a majority (51%) supporting the rule, but with “a large number of comments opposing various aspects of SBA’s approach to simplifying size standards.”⁸⁵ In addition, Representative Donald Manzullo (R-IL), chair of the House Committee on Small Business, and Senator Olympia Snowe (R-ME), chair of the Senate Committee on Small Business and Entrepreneurship, opposed the proposed rule.⁸⁶ Senator John Kerry (D-MA), ranking minority member of the Senate Committee on Small Business and Entrepreneurship, sent a letter to the SBA requesting that it “rescind its proposal to restructure the way companies are determined to be small businesses” because “small business advocates have informed me that this proposal could threaten or eliminate over 8 million jobs” and “the proposal would punish the 34,000 firms that are currently considered small, have been acting in good faith with the Federal government, but will lose their small business status abruptly as a result of the change.”⁸⁷ The SBA withdrew the proposed rule on July 1, 2004. Senator Snowe was quoted in a press interview later that day that she supported the SBA’s decision to rescind the proposed rule:

At the eleventh hour, the SBA has corrected its course and averted costly disruptions for small businesses across the country.... The SBA’s proposed rule would have sent a tidal wave crashing over small business, effectively wiping out the foundation on which countless firms currently operate. Small firms still recovering from last year’s slow economy are in no shape to cope with such a sea change in the regulatory landscape.⁸⁸

Senator Snowe reportedly urged the SBA to proceed cautiously with any future effort to restructure its size standards, emphasizing that any such effort should include a thorough dialogue with business owners and Congress.⁸⁹

In 2005, the SBA adjusted for inflation size standards based on firms’ annual sales or receipts (an upward adjustment of 8.7%). The SBA estimated that the adjustment restored eligibility to approximately 12,000 firms that lost small-business status due solely to the effects of inflation. In

⁸³ Ibid., pp. 13131, 13132.

⁸⁴ Ibid., p. 13138.

⁸⁵ U.S. Small Business Administration, “Small Business Size Standards: Selected Size Standards Issues,” 69 *Federal Register* 70197, December 3, 2004; and U.S. Small Business Administration, “Small Business Size Standards: Selected Size Standards Issues,” 70 *Federal Register* 2976, January 19, 2005.

⁸⁶ U.S. House Committee on Small Business, “Manzullo Commends SBA for Reexamining Proposed Size Standard Changes,” press release, July 1, 2004, http://republicans.smbiz.house.gov/press/asp_display_press_releases.asp?pressReleaseId=50; and U.S. Newswire, “Snowe Hails SBA’s Withdrawal of New Size Standards Proposal; Decision Spares Small Firms Costly Disruptions,” Washington, DC, July 1, 2004, p. 1, <http://proquest.umi.com/pqdweb?did=657675071&sid=1&Fmt=3&clientId=45714&RQT=309&VName=PQD>.

⁸⁷ U.S. Senate Committee on Small Business and Entrepreneurship, “Kerry Urges SBA to Withdraw Small Business Size Standard Proposal,” press release, June 29, 2004, <http://sbc.senate.gov/press/record.cfm?id=223511>.

⁸⁸ U.S. Newswire, “Snowe Hails SBA’s Withdrawal of New Size Standards Proposal; Decision Spares Small Firms Costly Disruptions,” Washington, DC, July 1, 2004, p. 1, <http://proquest.umi.com/pqdweb?did=657675071&sid=1&Fmt=3&clientId=45714&RQT=309&VName=PQD>.

⁸⁹ Ibid.

2008, the SBA made another adjustment for inflation to its annual sales- and receipts-based standards (another upward adjustment of 8.7%). The SBA estimated that the adjustment restored eligibility for approximately 10,400 firms that lost small-business status due solely to the effects of inflation.⁹⁰

The SBA announced in June 2008 that it would undertake a comprehensive, two-year review of its size standards, proceeding one industrial sector at a time, starting with retail trade, accommodations and food services, and other services (repair and maintenance, personal and laundry services, and religious, grantmaking, civic, professional, and similar organizations).⁹¹ The SBA argued that it was concerned that “not all of its size standards may now adequately define small businesses in the U.S. economy, which has seen industry consolidations, technological advances, emerging new industries, shifting societal preferences, and other significant industrial changes.”⁹² It added that its reliance on an ad hoc approach “to scrutinizing the limited number of specific industries during a year, while worthwhile, leaves unexamined many deserving industries for updating and may create over time a set of illogical size standards.”⁹³

The SBA announced that it would begin its analysis of its size standards by assuming that “\$6.5 million is an appropriate size standard for those industries with receipts size standards and 500 employees for those industries with employee size standards.”⁹⁴ It would then analyze the following industry characteristics: “average firm size; average asset size (a proxy for startup costs); competition, as measured by the market share of the four largest firms in the industry; and, the distribution of market share by firm size—that is, are firms in the industry generally very small firms, or dominated by very large firms.”⁹⁵ Then, before making its final determination on the size standard, it would “examine the participation of small businesses in Federal contracting and SBA’s guaranteed loan program at the current size standard level. Depending on the level of small business participation, additional consideration may be given to the level of the current size standard and the analysis of industry factors.”⁹⁶

The SBA later announced in its Semiannual Regulatory Agenda, published on November 24, 2008, that it planned to issue a notice of proposed rulemaking concerning size standards for the retail trade, accommodations and food services, and other services industrial classifications in January 2009.⁹⁷ Although the proposed notices were not issued in January, the SBA is continuing its review and plans to issue proposed notices for those industries in the near future.⁹⁸

⁹⁰ U.S. Small Business Administration, “Small Business Size Standards, Inflation Adjustment to Size Standards; Business Loan Program; Disaster Assistance Loan Program,” 70 *Federal Register* 72577, December 6, 2005; and U.S. Small Business Administration, “Small Business Size Standards: Inflation Adjustment to Size Standards; Business Loan Program, and Disaster Assistance Loan Program,” 73 *Federal Register* 41237-41254, July 18, 2008.

⁹¹ U.S. Small Business Administration, “Small Business Size Standards: Public Meetings on a Comprehensive Review of Small Business Size Standards,” 73 *Federal Register* 30440 - 30442, May 27, 2008.

⁹² *Ibid.*, p. 30441.

⁹³ *Ibid.*

⁹⁴ U.S. Small Business Administration, “Size Standards Comprehensive Review,” June 3, 2008, http://www.sba.gov/idc/groups/public/documents/adacct/june_3_public_presentation_rem.pdf.

⁹⁵ *Ibid.*

⁹⁶ *Ibid.*

⁹⁷ U.S. Small Business Administration, “Small Business Administration Semiannual Regulatory Agenda,” 73 *Federal Register* 71449, 71450, November 24, 2008.

⁹⁸ Telephone conversation between the author and staff of the U.S. Small Business Administration Office of Size Standards, October 8, 2009.

SBA's Current Definition for Small Business

Today, the SBA, relying on statutory language, defines a small business as a concern that is organized for profit; has a place of business in the United States; operates primarily within the United States or makes a significant contribution to the economy through payment of taxes or use of American products, materials, or labor; is independently owned and operated; and is not dominant in its field on a national basis. The business may be a sole proprietorship, partnership, corporation, or any other legal form.⁹⁹

In addition, the SBA uses four criteria to determine program eligibility for firms in 1,159 industrial classifications described in the North American Industry Classification System (NAICS): (1) number of employees, (2) average annual receipts in the previous three years, (3) asset size, or (4) for electrical power industries, the extent of power generation.¹⁰⁰ The SBA's application of these criteria varies by industry.

The SBA uses employment size to determine eligibility for manufacturing firms, with most (343 of 476 manufacturing classifications, or 72%) having an upper limit of 500 employees; some having an upper limit of 750 employees (61 of 476 classifications, or 13%); some having an upper limit of 1,000 employees (70 of 476 classifications, or 15%); and 2 (ammunition, other than small arms, manufacturers and aircraft manufacturers) having an upper limit of 1,500 employees. It also uses employment size to determine eligibility for mining firms, with 26 of 30 mining industrial classifications having an upper limit of 500 employees (the four exceptions are in mining support industries); and for firms in the wholesale trades industry, with all 71 wholesale trade classifications having an upper limit of 100 employees. Overall, the SBA uses seven different size standards using the firm's number of employees (50 or fewer, 100 or fewer, 150 or fewer, 500 or fewer, 750 or fewer, 1,000 or fewer, and 1,500 or fewer employees) in 607 industrial classifications.

The SBA uses average annual receipts over the three most recently completed fiscal years to determine program eligibility for most other industrial classifications.¹⁰¹ Overall, the SBA uses 33 different size limits using the firm's average annual sales or receipts, ranging from no more than \$0.75 million to no more than \$35.5 million, to determine program eligibility in 541 industrial

⁹⁹ U.S. Small Business Administration, "FAQs: Frequently Asked Questions: Small Business Size Standards," <http://www.sba.gov/contractingopportunities/officials/size/sbss/index.html>. Note: Affiliations between businesses, or relationships allowing one party control or the power of control over another, generally count in size determinations. Businesses can thus be determined to be other than small because of their involvement in joint ventures, subcontracting arrangements, or franchise or license agreements, among other things, provided that their personnel numbers or income, plus those of their affiliate(s), are over the pertinent size threshold. For further analysis, see CRS Report R40744, *The "8(a) Program" for Small Businesses Owned and Controlled by the Socially and Economically Disadvantaged: Legal Requirements and Issues*, by John R. Luckey and Kate M. Manuel.

¹⁰⁰ U.S. Small Business Administration, "Guide to SBA's Definitions of Small Business," http://www.sba.gov/idc/groups/public/documents/sba_homepage/guide_to_size_standards.pdf. Note: The number of employees of a concern is its average number of persons employed for each pay period over the concern's latest 12 months. Any person on the payroll must be included as one employee regardless of hours worked or temporary status. Also, if a concern has not been in business for three years, the average weekly revenue for the number of weeks the concern has been in business is multiplied by 52 to determine its average annual receipts.

¹⁰¹ The annual receipts of a concern which has been in business for less than three complete fiscal years is determined by dividing the total receipts for the period the concern has been in business by the number of weeks in business, multiplied by 52. See, 13 C.F.R. § 121.104.

classifications. In most instances, there is some variation in the size standards used within each industrial classification. In general:

- most administrative and support service industries have an upper limit of \$7 million in average annual sales or receipts;
- most agricultural, forestry, fishing, and hunting industries have an upper limit of \$0.75 million in average annual sales or receipts;
- most general building and heavy construction industries have an upper limit of \$33.5 million in average annual sales or receipts;
- most educational services industries have an upper limit of \$7 million in average annual sales or receipts;
- most health care and social assistance industries have an upper limit of \$7 million or \$10 million in average annual sales or receipts;
- most retail trade industries have an upper limit of \$7 million in average annual sales or receipts;
- most professional, scientific, and technical service industries, including mining services, have an upper limit of \$7 million in average annual sales or receipts;
- most real estate, rental and leasing industries have an upper limit of \$2 million or \$7 million in average annual sales or receipts;
- most transit and ground passenger transportation, scenic and sightseeing transportation, and support activities for transportation industries have an upper limit of \$7 million in average annual sales or receipts; and
- most waste management and remediation services industries have an upper limit of \$12.5 million in average annual sales or receipts.¹⁰²

The SBA also applies a \$175 million asset limitation for eligibility purposes for six industrial classifications: commercial banks, saving institutions, credit unions, other depository credit intermediation, credit card issuing, and international trade financing. It also applies a four million megawatt limitation for eligibility purposes for six power generation and transmission industrial classifications: hydroelectric power generation, fossil fuel electric power generation, nuclear electric power generation, other electric power generation, electric bulk power transmission and control, and electric power distribution.¹⁰³ Overall, the SBA classifies about 99.7% of all employer firms as small.¹⁰⁴ These firms account for approximately half of the nation's gross domestic product, half of the nation's total employment, and 44% of the nation's private sector payroll.¹⁰⁵

¹⁰² U.S. Small Business Administration, "Table of Small Business Size Standards Matched to North American Industry Classification System C," http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_sstd_table.pdf.

¹⁰³ Ibid.

¹⁰⁴ Ibid.; and U.S. Small Business Administration, "Fiscal Year 2010 Congressional Budget Justification," Washington, DC: U.S. Small Business Administration, 2009, p. 75, http://www.sba.gov/idc/groups/public/documents/sba_homepage/serv_budget_2010_justification.pdf.

¹⁰⁵ U.S. Census Bureau, *Statistics of U.S. Businesses: 2006*, Washington, D.C., <http://www.census.gov/econ/subs/>. For further analysis see CRS Report RS22688, *Selected Small Business Statistics*, by N. Eric Weiss.

Currently, federal agencies are required to use SBA size standards, or establish their own size definitions after conferring directly with the SBA's Office for Advocacy, for procurement purposes.¹⁰⁶ For other federal programs or statutes offering support for small business, the definition of a qualified firm does not necessarily have to conform to the SBA's size standards. In general, the four criteria used by the SBA to define small businesses are currently being used to identify firms eligible for federal small business support.

The SBA Administrator has the authority to modify size standards for particular industries. Before a proposed change can take effect, SBA's Office of Size Standards (OSS) is required to undertake an analysis of the likely impact of the change on the performance of the affected industry or industries, focusing on the degree of competition, average firm size, start-up costs, barriers to entry, and the distribution of sales and employment by firm size. It also considers technological changes, growth trends, historical activity within an industry, unique factors occurring in the industry which may distinguish small firms from other firms, and the objectives of its programs and the impact on those programs of different size-standard levels.¹⁰⁷ It uses the results to make recommendations to SBA's Size Policy Board. If the board agrees with OSS's recommendations, then it normally advises the Administrator to approve the proposed change.

Any changes to size standards must follow the rulemaking procedures of the Administrative Procedure Act¹⁰⁸. A proposed rule changing a size standard is first published in the *Federal Register*¹⁰⁹, allowing for public comment. It must include documentation establishing that a significant problem exists that requires a revision of the size standard, plus an economic analysis of the change. Comments from the public, plus any other new information, are reviewed and evaluated before a final rule is promulgated establishing a new size standard.¹¹⁰

Congressional Policy Options

Historically, the SBA has relied on economic analysis of market conditions within each industry to define eligibility for small business assistance. On several occasions in its history, the SBA has attempted to revise its small business size standards in a comprehensive manner. However, because (1) the Small Business Act provides leeway in how the SBA is to define small business; (2) there is no consensus on the economic factors that should be used in defining small business; (3) federal agencies have generally opposed size standards that might adversely affect their pool of available small business contractors; and (4) the SBA's initial size standards provided program eligibility to nearly all businesses, the SBA's efforts to undertake a comprehensive reassessment of its size standards have met with resistance. Firms that might lose eligibility objected. Federal

¹⁰⁶ The federal government has a goal of awarding at least 23% of all federal government buying targeted to small firms, including 5% for small disadvantaged businesses, 5% for women-owned small businesses, 3% for small businesses owned by service-disabled veterans, and 3% for small businesses located in a HUBZone. See, U.S. Small Business Administration, "Small Businesses Won Record \$93.3 Billion in Federal Contracts," Washington, DC, August 21, 2009, http://www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_09-60.pdf.

¹⁰⁷ 13 C.F.R. § 121.102.

¹⁰⁸ See <http://www.archives.gov/federal-register/laws/administrative-procedure/552.html>.

¹⁰⁹ See <http://www.gpoaccess.gov/fr/>.

¹¹⁰ U.S. Small Business Administration, "FAQs: Frequently Asked Questions: Small Business Size Standards," <http://www.sba.gov/contractingopportunities/officials/size/sbss/index.html>.

agencies also objected. As a result, in each instance, the SBA's comprehensive revisions were not fully implemented.

It remains to be seen whether the SBA will renew its efforts to rely more heavily on firm employee size as a factor in determining program eligibility, or if its current, ongoing review of each industrial classification in a sequential fashion will result in significant changes to its size standards. In the meantime, the SBA continues to adjust its annual sales and receipts limitations for inflation at least once every five years, or more frequently if inflationary circumstances warrant, to prevent firms in industrial classifications that use those factors for from losing their eligibility solely due to the effects of inflation. It also continues to review size standards within specific industries whenever it determines that market conditions within that industry have changed.

Congress has several options related to the SBA's ongoing review of its size standards. For example, as part of its oversight of the SBA, Congress can (1) wait for the agency to issue its proposed rule before providing input, or (2) establish a dialogue with the agency, either at the staff level or with Members involved directly, prior to the issuance of its proposed rule. Historically, Congress has tended to wait for the SBA to issue proposed rules concerning its size standards before providing input, essentially deferring to the agency's expertise in the technical and methodological issues involved in determining where to draw the line between small and large firms. Congress has then tended to respond to the SBA's proposed rules concerning its size standards after taking into consideration current economic conditions and input received from the SBA and affected industries.

Waiting for the SBA to issue its proposed rule concerning its size standards before providing congressional input has both advantages and disadvantages. It provides the advantage of insulating the proposed rule from charges that it is influenced by political factors. It also has the advantage of respecting the separation of powers and responsibilities of the executive and legislative branches. However, it has the disadvantage of heightening the prospects for miscommunication, false expectations, and wasted effort, as evidenced by past proposed rules concerning the SBA's size standards that were either rejected outright, or withdrawn, after facing congressional opposition.

One policy issue that has not received much congressional attention in recent years, but which Congress may choose to address, is the targeting of the SBA's resources. When the SBA reviews its size standards, it focuses on the competitive nature of the industry under review, with the goal of removing eligibility of firms that are considered large, or dominant, in that industry. There has been relatively little discussion of the costs and benefits of undertaking those reviews with the goal of targeting SBA resources to small businesses that are struggling to remain competitive. GAO recommended this approach in 1978 and Roger Rosenberger, then SBA's Associate Administrator for Policy, Planning and Budgeting, testified at a congressional hearing in 1979 that it was debatable whether the SBA should provide any assistance to any of the businesses within industries where "smaller firms are flourishing."¹¹¹

Revising the SBA's size standards using this more targeted approach would likely reduce the number of firms eligible for assistance. It would also present the possibility of increasing

¹¹¹ U.S. Congress, House Committee on Small Business, Subcommittee on General Oversight and Minority Enterprise, *Size Standards for Small Business*, hearing, 96th Cong., 1st sess., July 10, 1979 (Washington: GPO, 1979), p. 28.

available benefits to eligible small firms in those industries deemed “mixed” or “concentrated” by the SBA without necessarily increasing overall program costs. Perhaps because previous proposals that would result in a reduction in the number of firms eligible for assistance have met with resistance, this alternative approach to determining program eligibility has not received serious consideration in recent years. Nonetheless, it remains an option available to the Congress should it decide to change current policy.

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