

Testimony of Dr. Aaron K. Chatterji, Ph.D.

Assistant Professor at the Fuqua School of Business, Duke University

**U.S. House of Representatives, Committee on Small Business
June 19th, 2008**

“Small Business Exports in the Current Economic Climate.”

Chairwoman Velazquez and members of the committee, thank you for inviting me to testify today about this important economic policy issue, one that, with the notable exception of the work of this committee, does not always get the attention it deserves.

My name is Aaron Chatterji and I am an assistant professor at Duke University’s Fuqua School of Business, where my research focuses on entrepreneurship and small business. I am also a Fellow at the Center for American Progress in Washington D.C., where I am an economic policy adviser, working on issues related to the intersection of business and public policy.

In my view, American small businesses are not just the backbone of our economy, but also a lynchpin in our broader society, creating millions of jobs and anchoring our local communities. In the various places I have lived across the country, whether in Upstate NY where I was born and raised, northern California where I attended graduate school, or the Research Triangle in North Carolina where I live today, I have seen firsthand how the fortunes of small businesses can be a critical variable in the overall economic health of a region. I have also observed that immigrants to our country, like my parents, have often started small businesses as a means of moving up the economic ladder and providing a better life for their children. Finally, I have studied how global economic forces are changing the competitive landscape for our small businesses, presenting new threats but also new opportunities.

However, in current economic policy debates, American small businesses are often an afterthought. Some recommendations seem to be driven by the assumption that what benefits the Fortune 100 will automatically trickle down to America’s 26 million small businesses. I think the real story is more complicated than that and I believe that federal, state, and local governments have numerous tools at their disposal that can help small businesses grow and prosper. Of course, the widely admired entrepreneurial initiative of America’s small business owners will be the most important driver of success. The difficult challenge for government policy will be to harness that initiative rather than hinder it.

In the spirit, let me offer a few thoughts on the issue being discussed here today, the export outlook for American small business. While there are many reasons to be

concerned about the future of the American economy, rising energy costs, the turmoil in the mortgage market, an increase in the unemployment rate, American exports have fared quite well, in part due to the declining value of the U.S. dollar. The weakening dollar makes our goods cheaper to foreigners, and as a result, American exports are up 16.6% compared to last year according to Commerce Department data from January 2008. This is a bright spot in our economy with the potential to make a dent in our \$700 billion trade deficit and has accounted for a large part of our economic growth in recent quarters.

Upon closer inspection of the data however, we might be concerned that the majority of American businesses, specifically small businesses, are not benefiting as much as they could be from the favorable climate for exports. According to the Small Business Exporting Association, 240,000 of our small businesses are exporting, accounting for \$450 billion in value. But these businesses represent a tiny fraction, less than 1% of all small businesses. Furthermore, over 60% of the exporting small businesses are selling to only one nation, with the most popular destinations being Canada and Mexico. In total, our small businesses account for 29% of the total value of all exports, and that number, according to various sources has stayed relatively stable over the last few years. On the other hand, we have seen double digit increases in the overall value of exports, from \$1.4 trillion to \$1.6 trillion, an increase of 12% in 2007. This followed another 12% increase in 2006, according to the Commerce Department.

So, while we might hear encouraging statistics about the percentage of exporters that are small businesses, we should also look at the percentage of total value accounted for by smaller firms. Also, we should closely examine those industries where small businesses make up the majority of firms, like the 94% of machinery manufacturers and 93% of computer producers.¹ Interestingly, in some of these industries, including lumber and textiles, we currently see a decline in exports compared to 2007.² While we can never expect complete parity with large businesses in terms of export value, these numbers indicates that there is room to grow. We have a huge interest in promoting exporting among small business, because of its association with higher wages and more steady firm performance.

While I should caution you that there are several caveats and exceptions embedded in these data, taken together with the current economic climate, they indicate that we should consider policies to aid U.S. small businesses in accessing foreign markets. Let me briefly conclude by describing a few of the challenges faced by small business and potential policy responses.

The first challenge is a general lack of awareness on the part of small business as to the opportunities to do business abroad. Imagine an entrepreneur who manages a small company, and only reads about the competitive threats from foreign economies, rather than the huge potential market for her own company. With so many day to day business needs, most business owners simply do not think about the possibility of exporting.

¹ Data from Small Business Administration (sba.gov)

² U.S. Census, U.S. Bureau of Economic Analysis, June 2008

However, the opportunities for doing business abroad are only increasing. Large markets such as China and India are well suited for our small businesses because small businesses in these developing nations often lack the technical sophistication to supply larger firms. For just one example, think about the growing Chinese airline market and how important this market could be to American machine tool manufacturers.³ Emerging markets all across the world will be growing and liberalizing, and these developments present huge opportunities for U.S. small business if we can improve our trade promotion initiatives.

The trade promotion initiatives at all levels of government should be better coordinated and ought to provide practical and clear information about foreign markets and cultures, concrete steps to begin the process of exporting, and additional services to those needing more information. Many people have said this before, but I want to add one insight from my own research and the academic literature on entrepreneurship. Entrepreneurship is a highly social process. Most small businesses are not founded by two guys in a garage. Rather, prospective entrepreneurs rely on their own social networks for advice, capital, and identifying new business opportunities. Immigrant entrepreneurs in particular have already established strong business links to their native lands, and could be leveraged to increase U.S. exports to a wide variety of countries. I believe that our trade promotion assistance programs could do a better job of taking these factors into account, perhaps identifying key small business owners across the country to act as conduits between the government and the 99% of small businesses that do not export.

The second challenge facing small businesses looking to export is the transaction costs associated with selling goods abroad. Custom fees, physical presence requirements, and other costs of doing business tend to hurt smaller firms more than large ones.⁴ Innovations in both the private and public sector in recent years have lowered these transaction costs. The rise of the Internet, and more specifically e-commerce, has allowed small businesses to expand their reach globally. For example, the Associated Press reported on an antique coin company in Holland, Pennsylvania that saw its sales to foreigners grow by 65% in 2007.⁵

While advances in technology have dramatically lowered the costs of connecting American small businesses and foreign customers, small businesses still often find it costly to do the due diligence required to screen potential buyers. Social networking tools and cheap communication methods like instant messenger and Skype can help to build these relationships⁶, but there is still no substitute for face to face meetings. The U.S. Export Assistance Center offers the gold key service which helps efficiently match small

³ Fredenberg, Paul. "Are we losing the China market?" American Machinist, June 11th, 2008 (<http://www.americanmachinist.com/304/Issue/Article/False/80860/Issue>)

⁴Testimony to the Committee on Foreign Affairs in the U.S. House of Representatives, James Morrison, Small Business Exporters Association (http://www.nsba.biz/docs/sbea_testimony__hfac__24_apr_08_final.pdf)

⁵"Weak dollar helping some web businesses." The Associated Press, Oct. 30, 2007 <http://www.msnbc.msn.com/id/21548226/>

⁶ Bandyk, Matthew. "Tips for Small Businesses Looking Abroad." U.S. News and World Report, February 22nd, 2008 (<http://www.usnews.com/articles/business/small-business-entrepreneurs/2008/02/22/tips-for-small-businesses-looking-abroad.html>)

businesses with pre-screened customers abroad. The Export-Import Bank has an insurance program to guard against the risks of doing business abroad as well. These programs, especially gold key, seem to be well received and should continue to be evaluated.

Finally, let me also make what may sound like a personal appeal, but actually has broader implications. We need better data on small businesses. This will not just benefit researchers, but also policymakers, who will be better able to separate out real trends from statistical artifacts. One example is how we account for service exports, which do not seem to be accurately captured in the current data.⁷ We might be missing a large percentage of small business exports, in areas like financial and technology services. For example, the New York Times reported earlier this year on a small investor relations firm, MBS Value Partners, which is finding that midsize European businesses are interested in their services because of the declining dollar. If we could accurately capture service exports, we might find a vastly different picture of small business exporting, requiring different policy responses.

In conclusion, we all agree that small businesses are a critical part of our economy and a tremendous driver of job creation and economic growth. With so many Americans working for small businesses, and so many communities dependent on them, the goal of increasing exports for these firms should be a top priority. Moreover, given current economic conditions, it seems that the time is right to enact policies to help American small businesses expand their scope globally. If we can succeed in increasing the number of small businesses that export and increase the number of countries they export to, we will have a stronger, more resilient economy. By refining our trade promotion activities, lowering the costs of doing business abroad, and increasing our understanding of the reality behind our imperfect data, I believe we can achieve this goal.

Thank you for inviting me and I will take any questions you might have at this time.

⁷ Testimony to the Committee on Foreign Affairs in the U.S. House of Representatives, James Morrison, Small Business Exporters Association
(http://www.nsba.biz/docs/sbea_testimony__hfac__24_apr_08_final.pdf)