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SMALL BUSINESS AND ECONOMIC MOBILIZATION

1 March 1956

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

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Mr. Wendell B. Barnes, Administrator, Small Business Administration, was born in Ponca City, Oklahoma, 23 August 1909. He is a graduate of Culver Military Academy, Brown University, and the University of Michigan, receiving his law degree in 1935. From 1935 to 1939 he was Assistant Attorney for the Oklahoma Tax Commission. In 1939 he became a partner in the law firm of Gavin and Barnes. From October 1941 to June 1946 he was General Counsel for the Tulsa plant of Douglas Aircraft Company, Inc. Much of his work involved Government procurement procedures, negotiated prime contracts with the Air Force as well as supervised or approved thousands of purchase orders and subcontracts for supplies from small businesses. Prior to entering Government service, he was a practicing attorney, and (as an adjunct to) his law practice, organized and managed several small businesses, in Oklahoma. He served in the House of Representatives of the Oklahoma legislature from 1950 to 1952. He is a member of the Oklahoma Bar, the Bar of the U.S. Supreme Court, the American Bar Association, and the American Judicature Society. He is treasurer of the Federal Bar Association and a member of the Association's National Council. This is his first lecture at the Industrial College.

SMALL BUSINESS AND ECONOMIC MOBILIZATION

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GENERAL CALHOUN: Gentlemen: The subject for our lecture today is "Small Business and Economic Mobilization."

In last Tuesday's issue of the Wall Street Journal, a congressman was reported as saying, "Small business has always been something you had to have, like honesty, or the American flag, but this year it seems Democrats and Republicans alike are hugging small business tighter than ever."

It is only natural that we might hear more on the subject of small business during an election year than we would ordinarily; but one thing is sure--we will not soon forget it. Congress has seen to that. It is our job to learn the position of small business in our economy and how it can best contribute to our security.

Our speaker is not only for small business, but he is the one man in this country doing probably most about it. He is Mr. Wendell B. Barnes, the Administrator of the Small Business Administration.

I learned just before coming over that he is a graduate of this institution, having graduated from the field course at Tulsa in 1952.

It is a privilege to have you with us, Mr. Barnes, and to present you to this class.

MR. BARNES: General, Gentlemen: It is a privilege for me to come over here and discuss some of my problems and the importance of small business to our economy, particularly to the mobilizing economy during an emergency.

It is true that the small business question is a controversial one. Our agency always seems to be existing in the heart of a controversy. And yet it is true that we are something like motherhood, or honesty. Last year when our bill came before Congress it passed unanimously in both the House and the Senate. Again, just after Christmas this year, we had a measure up there increasing our authority to have disaster loans outstanding, and again both Houses passed the bill promptly, without a dissenting vote. I don't think that is so much a

tribute to my administration of the affairs of our agency, although I like to think it is good, but rather I think this is an election year.

Having had the pleasure and the advantage of taking the field course, I felt one of the things we should do early in the game is to see that more of our people in the Small Business Administration were given the opportunity to take the course. Mr. Ernest Reisner, who is with me this morning, and who is the head of one of our departments, was a graduate of the full-year course in 1952. Two years ago we worked out an arrangement so that each of our employees would at least be given the opportunity to take the correspondence course, and I am happy to report to you gentlemen that, as of the present, we have 17 men enrolled in the correspondence course; 12 have completed the correspondence course; one has completed the 10-months resident course. The Administrator and two Deputy Administrators have finished the field course. I think, for an agency that has 750 employees, that means that we are doing our part to take advantage of the things you have to offer and to be familiar with the plans that can be and should be made for mobilization.

Very briefly, I will review the functions of the Small Business Administration. That will not be the principal topic of my talk, but will be something so that you will know what the agency is and does. I will just review them briefly.

This agency was created by an act of Congress in August 1953. It superseded and assumed most of the functions of two previous agencies--the Small Defense Plants Administration and the Reconstruction Finance Corporation. Now, in some areas the activities were a little bit more limited than those of the previous two agencies, in that we do not have the large rubber and tin programs and have a limit on the size of our loans, which the RFC did not have. But, insofar as the Small Defense Plants Administration is concerned, their function was limited chiefly to defense manufacture, although some 400,000 businesses were actually eligible for the type of assistance they could give. We have no such limitation, so that we are obligated to work with and try to bring assistance to the some four million small businesses in this country.

Our policies, other than the ones I have mentioned, are somewhat similar to the RFC as to loans. Ninety percent of the RFC loans were for amounts under 100,000 dollars. We have a maximum limit of 250,000 dollars on each of our loans, so that we can go into larger areas than were 90 percent of the RFC loans.

We have three basic functions: First, to make certain that adequate credit is available at reasonable rates for small business concerns. We do that by a financial-assistance program in which we are required by law to insist that borrowers first try to get the desired financing from a private bank, and, if that is not available, that they solicit a participation loan from the bank with SBA. Only if those two routes are not available will we consider a direct loan. We make loans if, generally speaking, their management has been good, if they have sufficient collateral to provide security for the loan, and if their record of earnings is such that, if they get the loan, there will be reasonable grounds to believe that the loan will be repaid.

We have some 40 field offices in various cities around the country.

The second function under financing is that we are obligated to make disaster loans whenever a natural catastrophe occurs, such as flood, hurricane, or storm of any kind which results in damage to businesses or home owners. We make loans to them, to home owners and businesses. In this activity we have been busy in New England last fall and since Christmas in California.

Our second major function is to make certain that small businesses have a fair opportunity, and an equal opportunity, to bid on the purchases of the Government of supplies and equipment, and that a fair share of the Government's purchases goes to the small firms in the Nation. We do this by working very closely with the Defense Department and other Government Procuring Agencies. We have what we call a Joint Determination Program, in which employees of the Defense Department and our employees screen proposed procurement, and the ones that either historically have been made and manufactured by small concerns or which they are capable of manufacturing are set aside for their exclusive bidding. There is still competitive bidding for this type of procurement, of course. The overall effort is to keep the mobilization base broad.

The Defense Department and the services have basic responsibility, of course, in the procurement field, and we try not to interfere with that, but try to work in a cooperative way with them. They have responsibilities assigned under their laws for making certain also that a fair share of procurement goes to small firms. The reason, of course, for that is that small firms are somewhat at a disadvantage in competing for Government contracts, many of the large companies being able to maintain Washington representatives and a staff that can keep

much better informed as to the Government's plans and requirements and future contracts that are coming up.

We have attempted to overcome this information problem in several ways. We have published for the first time what is called The United States Government Purchasing Directory, in which are listed all the procurement offices of the Government and each of the types of articles, supplies, and materials that are purchased at that particular installation. It not only lists the procurement offices of the Defense Department but also of the General Services Administration, the Veterans Administration, the Atomic Energy Commission, and the civilian or nondefense procuring offices of the Government.

This in effect puts in the hands of anyone who purchases the directory from the U.S. Government Printing Office for 50 cents a great deal of accurate, detailed information, so that he, in turn, can get on a bidder's list in various places around the country for the type of article he manufactures.

We also have issued a United States Government Specifications Directory, also available from the U.S. Government Printing Office. The motivation for this was that too many times in invitations to bid rather generalized specifications of the article are given, and the business man does not have available the prints and specifications that are needed to prepare his bid accurately and quickly. So there we have listed where each specification is available and have given very detailed information in the Government's procurement policies and practices.

The third major function of the Small Business Administration is to provide management and technical and production assistance to small firms. We do this by having experts from private industry, and the Government, if necessary, or from the professions, prepare small pamphlets on industrial subjects and management subjects, and we distribute most of them free. For certain types of publications and issues a small charge is made--20, 30, or 35 cents--for some of the lengthy publications.

This is an attempt to develop management information that is particularized and specialized for the problems of small firms, as you might assume, quickly. The course in accounting, such as is taught in one of the universities, is fine for specialists in accounting, but it may not be of too much help for a man who keeps his records

on slips of paper that he keeps in his hat, and whose wife makes up his statements once a month on the ironing board.

We are trying to develop simplified means of record keeping and tax information, as well as the more technical information, such as how to keep your tools in good condition, and how advertising can assist certain small marketers, and many of those subjects which are too lengthy to go into. We have probably 100 such titles now. They are very well received. On the U.S. Government Purchasing Directory, for instance, over 100,000 firms purchased the first issue, the first volume of that book, which was in existence for about 18 months, I think. The second volume was published during January of this year.

Well, this all is merely an attempt on the part of the Government to enable small firms to overcome some of the disadvantages they have merely because they are small, and to carry out the functions and policies expressed by Congress in the preamble of the Small Business Act of 1953, when it indicated that private enterprise, with the spirit of competition, is basic to this economy and to the concepts of Government and economic life in the United States.

Now, what is the present position of small business in the national economy, and how does it fit into economic mobilization? The small-business sector of the economy now comprises more than 4 million firms. There actually is a total of some 4,225,000 businesses of all sizes in the United States, as estimated on 30 June 1955. As I indicated, more than 4 million of these are small businesses, depending on the particular definition used.

About one-half of the workers in the United States work in small businesses. The proportion is somewhat less in manufacturing and greater in the service industries, but, to indicate to you gentlemen the importance of small businesses in the overall programs that you are studying, the latest information we have is that approximately one-third of the volume of manufacturing in the United States is done by companies which employ less than 500 people. It would be very foolish of any government group or military organization to ignore the potential economic capacity of so large a segment of the industrial complex as is included in the small business firms in the country.

I think the first thing we should do is to define small business. The Small Business Act of 1953 defines as small any business that is independently owned and operated and is not dominant in its field.

It further gives the Small Business Administration authority to issue further definitions based on number of employees and business volume. Traditionally the military, for 10 or 15 years, has used a definition that a business is small if it has fewer than 500 employees, including affiliates. There are advantages to this definition. It is easy to administer. Contracting officers can be very certain about size if they can ascertain the number of employees on a given date. There is no problem of making individual size determinations, as under some of the other definitions.

However, there are very serious inequities in this definition. Clearly, there are many firms in the size group between 250 and 500 that are not small, competitively speaking, in the particular industrial classification. Furthermore, there are some industries in which firms exceeding 500 employees are small, competitively speaking. It is these inequities that give us difficulty, and about which, frequently, Congressmen complain in their speeches in the Congressional Record.

We have attempted to work with the procuring offices, not only in the Defense Department, but in all of the civilian and defense procurement offices alike, in formulating a new definition that will retain the administrative advantages of the present definition as well as provide flexibility and additional equity in the future.

Of course this becomes important, because, in bidding on contracts, when a contract has been set aside for a small firm, if a firm is ruled out it is then ineligible, and its bid on the contract is not responsive, It does become important.

The definition used to determine eligibility for small business loans is a sliding scale, depending on the type of enterprise. In manufacturing it depends on employment. Any firm under 250 is considered small; any one over 1,000 is considered large. In between, they are large or small, depending on the size standard for their particular industry, based on the U.S. Department of Commerce Census of Manufactures. The size of nonmanufacturing firms depends on sales volume. Retailers are small if their gross business during the year is less than a million dollars. Wholesalers are small if their volume is less than 5 million dollars.

We have been using this definition in connection with loans, and it has worked out very well. In connection with procurement, we published a definition for criticism in the Federal Register the first

of the year, and we received virtually no criticism from the public on this new definition. However, the procurement agencies prefer that we retain the 500 standard but let them self-certify as to whether or not they are large or small under certain circumstances, and then have the SBA issue certificates in problem cases. That is the type of more flexible definition we will probably come up with and publish, probably in the next couple of weeks.

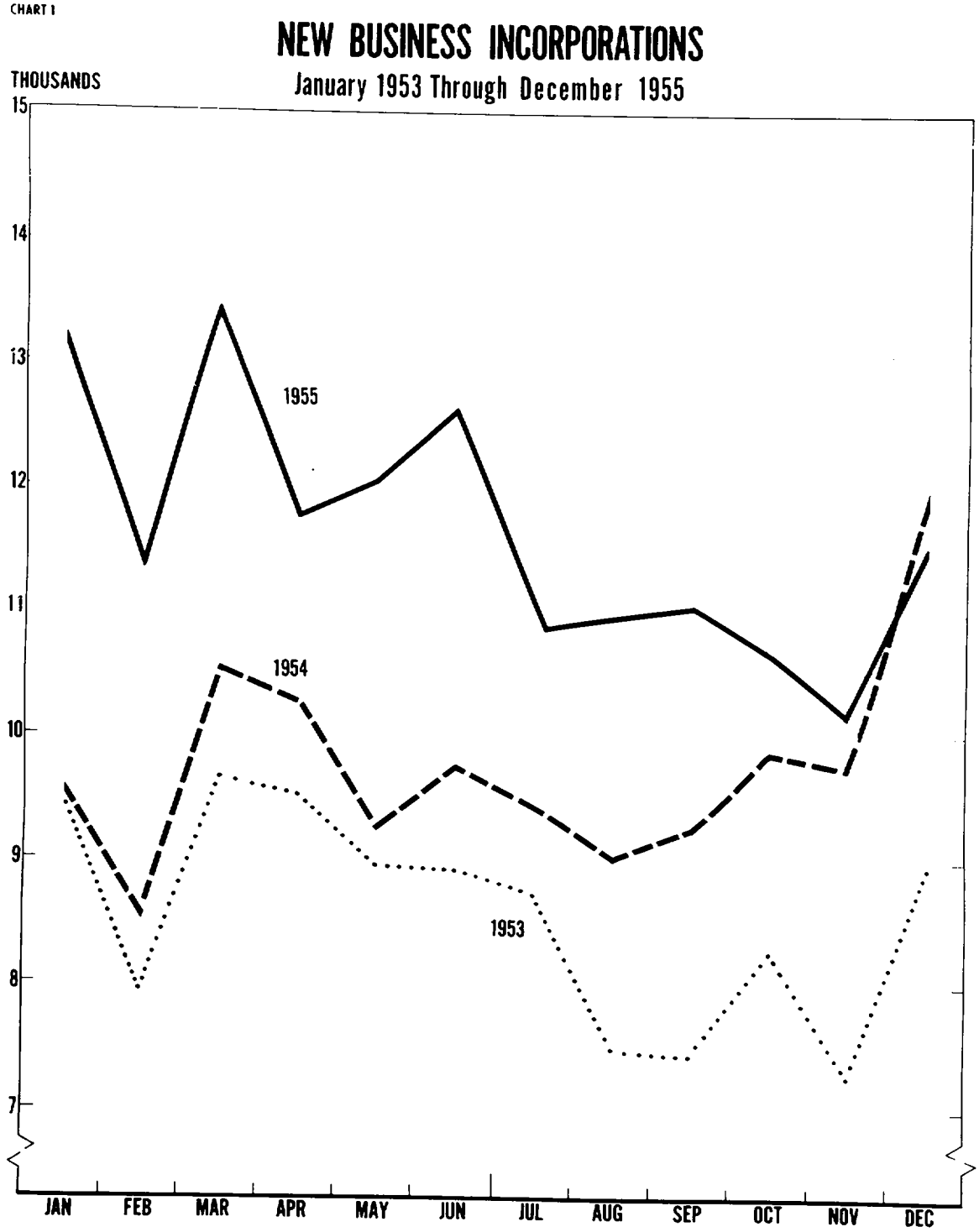
What is the situation of the small business in the national economy? Well, as you know, the national economy continues to expand. The gross national product, which was 375 billion in the first quarter of 1955, rose to 397 billion in the last quarter. The national income rose from 311 billion dollars in the first quarter to 331 billion in the last quarter. The improvement in the position of small business which took place in 1954, after a decline of several years, continued through the second half of 1955. This improvement has been reflected in various indicators which we follow very closely, such as sales, earnings before and after taxes, and earnings on stockholders' equity of manufacturing corporations. The increase in business incorporations is a significant index of the business boom. Last year there was a great number of business incorporations, 139,639, compared with 117,164 in 1954. That is shown on chart 1, page 8.

What are the reasons for new business incorporations? Well, there is usually one of two reasons. Either new projects are being organized and formed, indicating confidence of investors and businessmen in the future opportunities of the particular project, or a partnership or an individual is organizing a new company because of certain tax advantages he may obtain, which indicates that his earnings have been sufficiently good that he is worrying about the size and amount of taxes he will be forced to pay.

So that, as an indicator of small business health, new business incorporations is one of the best; and, as you can see, it was very high last year.

Now, in chart 2, page 9, the trend of business failures in 1954 was visibly downward, and in 1955 the failures were slightly below 1954. In 1955, the total number of business failures reported by Dun and Bradstreet was 10,969 compared with 11,086 in 1954. Since Dun and Bradstreet lists about 2,600,000 small businesses, this means that only about 10 businesses failed for every 2,600.

CHART 1



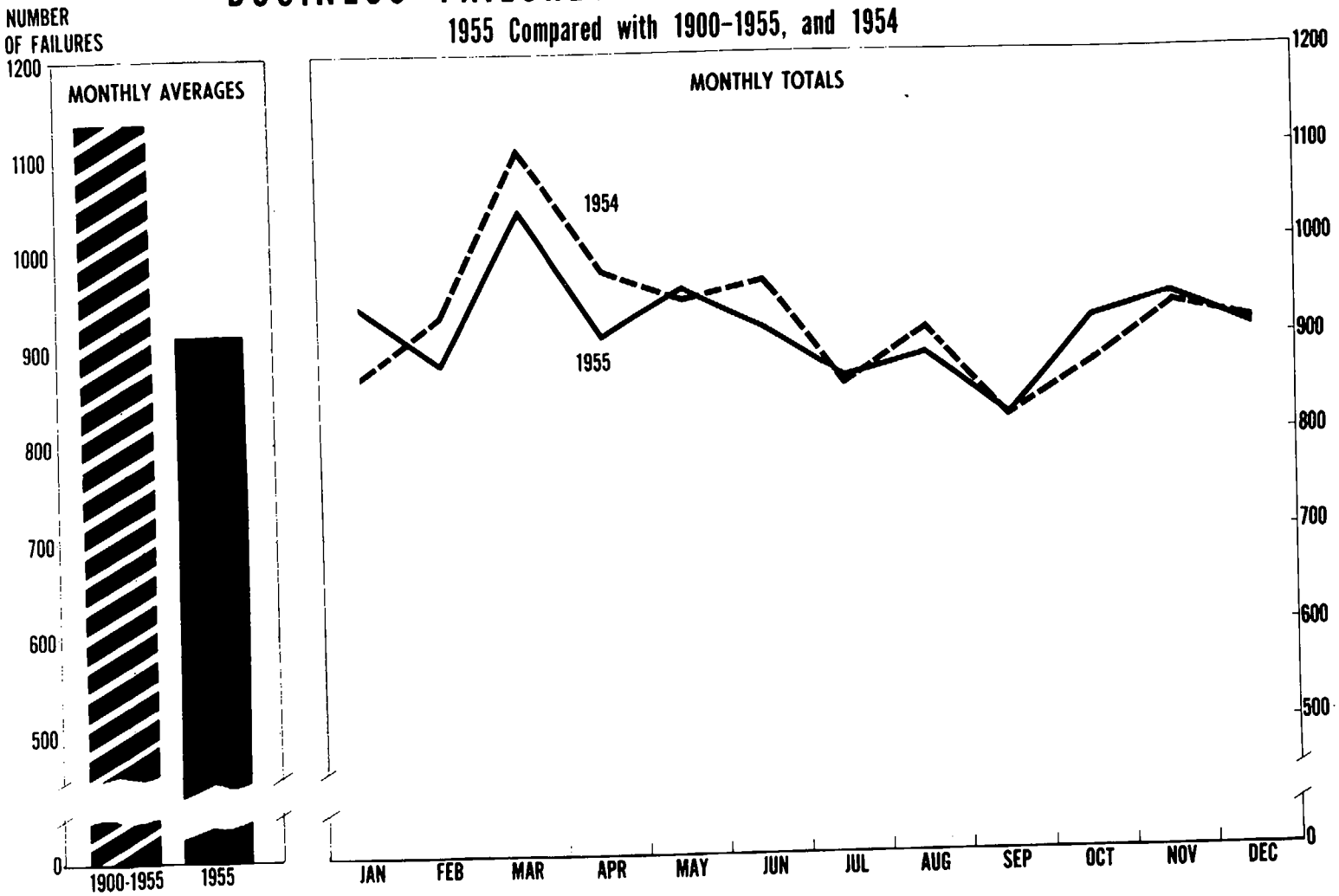
SOURCE: Dun & Bradstreet, Inc.

SMALL BUSINESS ADMINISTRATION

CHART 2

BUSINESS FAILURES IN THE UNITED STATES

1955 Compared with 1900-1955, and 1954



SOURCE DUN & BRADSTREET, INC

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You will occasionally, in the heat of political argument, hear someone, or see a statement by someone, that figures announced by Dun and Bradstreet last week showed a 10 percent increase in the rate of business failures over the figures of October, we will say. What are they telling you? They are telling you that one more out of every 2,600 businesses failed last week than in October. In other words, instead of the rate being 10, it is now 11. Of course they say nothing about the other 2,590 firms which, by every indication we have on our charts and in our files, are thriving and prospering, indeed.

Now, chart 3, page 11, shows earnings. For the four quarters through the third quarter of 1955 the earnings of small corporations, before taxes, increased to 1,245 million dollars, compared with 934 million dollars for the four preceding quarters--an increase of roughly one-third over the preceding year.

Similarly, small corporations' earnings after taxes increased to 627 million dollars from 442 million dollars, roughly an increase of about 40 percent.

This is also a very good indicator, and indicates that small business is improving its condition over a rather sorry position which it got into during and after the Korean War period, at a time during which large companies increased their relative position as compared with small businesses.

In chart 4, page 12, we show that the net sales of small manufacturing corporations with assets under one million dollars continued their recovery during 1955. During the second and third quarters of the year, net sales were 18,123 million dollars, compared with 16,813 million dollars in the corresponding quarters of 1954.

The rate of earnings before taxes on stockholders' equity for concerns under one million was 13.7 percent for the fourth quarter of 1954 through the third quarter of 1955. This is an increase from 11.2 percent in 1954.

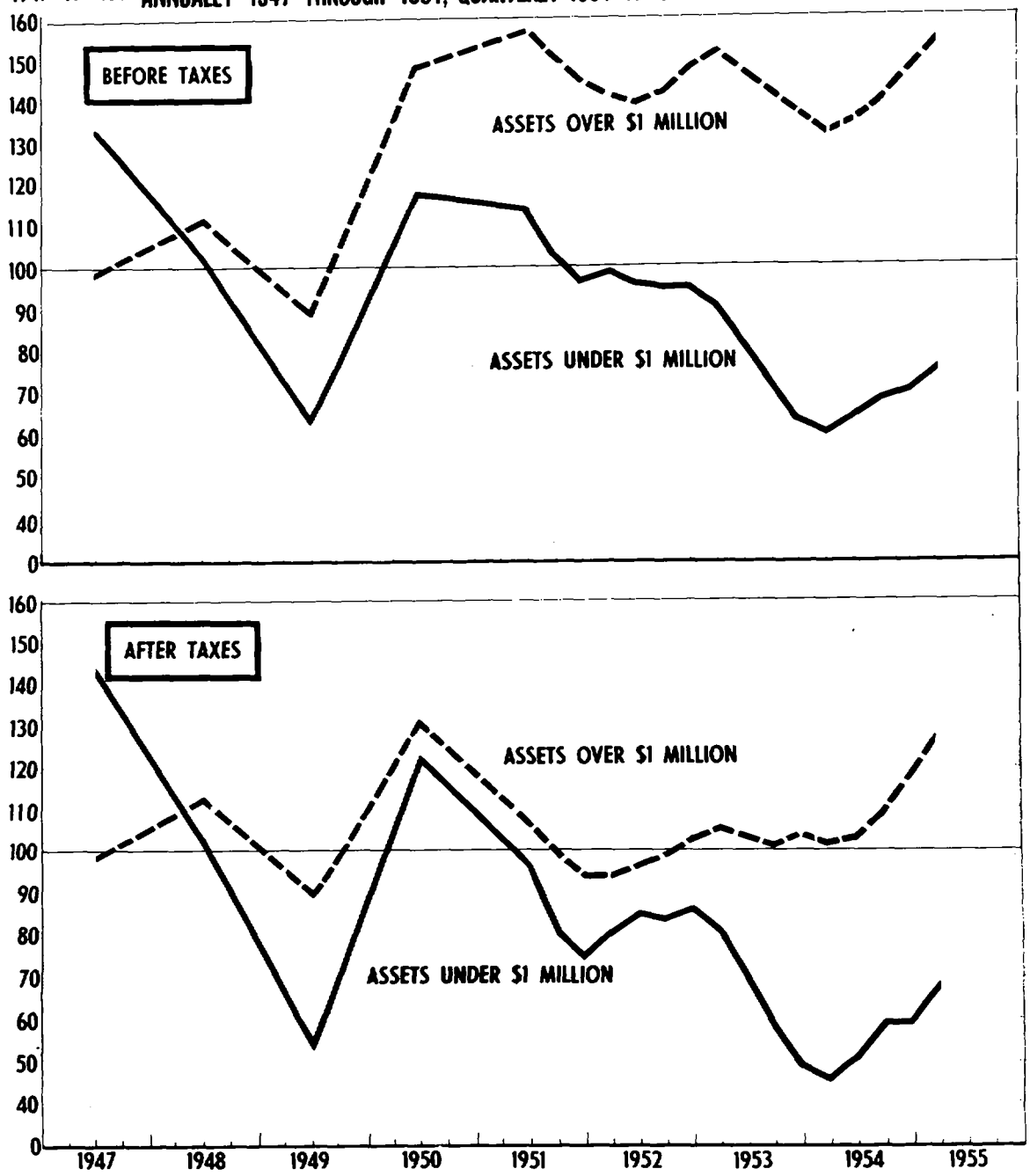
I give you the figures this way because figures for the fourth quarter of 1955 are not yet available. However, I am not concerned about the fourth quarter of 1955, because I think many of you, like I did, went into the stores from Thanksgiving until Christmas time and had to elbow through the crowds, and saw them selling spring

CHART 3

U. S. MANUFACTURING CORPORATIONS

EARNINGS BY ASSET SIZE

INDEX 1947-49=100 ANNUALLY 1947 THROUGH 1951, QUARTERLY 1951 THROUGH THIRD QUARTER 1955



NOTE: FOUR QUARTER MOVING AVERAGE, 1951-

SOURCE: Data based on Annual Reports of the Internal Revenue Service, Quarterly Reports of the Federal Trade Commission and Securities and Exchange Commission.

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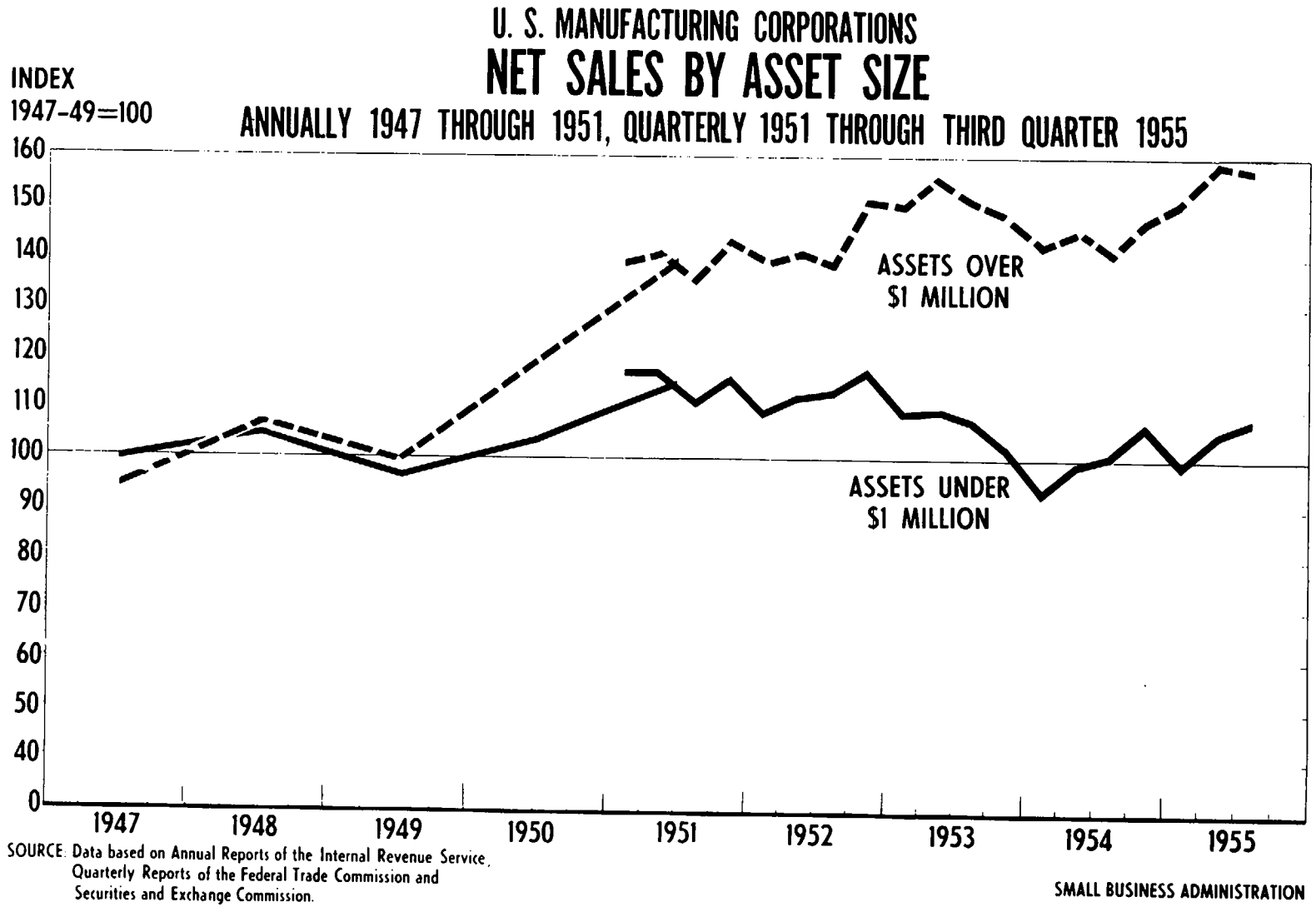
CHART 4



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short-sleeved shirts from their stocks, indicating that they had sold out their Christmas merchandise. So you will agree with me that business was very good indeed, during the fourth quarter.

There was a steady drop in earnings before taxes on stockholders' equity between 1947 and 1953, from 27.8 percent to 14.7 percent. This trend has now been reversed.

I may say that, from our charts, the turning point in the position of small business, insofar as we can see it, came with the enactment of the Revenue Act of 1954, which, while it did not do very much to reduce taxes, did correct certain inequities, allowed certain charge-offs, and contained many advantages to small firms. We feel also that the general prosperity and the confidence in President Eisenhower that has been exhibited by the business community generally has served to inspire this upward turn.

Now, chart 5, page 14, shows the small business share of military procurement. There is much argument about this. This block on the left shows the new procurement in fiscal year 1954. The small business share of awards in 1955 was 18 percent, slightly lower than the 18.3 percent in fiscal year 1954.

In net procurement, which means contracts after cancellations have been deducted, I believe the small business share in 1954 was 25.1 percent. Well this (indicating) is 5 billion, so you can see it is almost 3 billion. In 1955 it was 21.8 percent, but the volume is up. I am sure that you will recognize immediately that those figures can vary appreciably, depending on the type of procurement the Government happens to be engaging in at the moment. If it is a big tank program, it will distort those figures some. If it is an aircraft program, it will distort them, also. We are talking only about prime contracts.

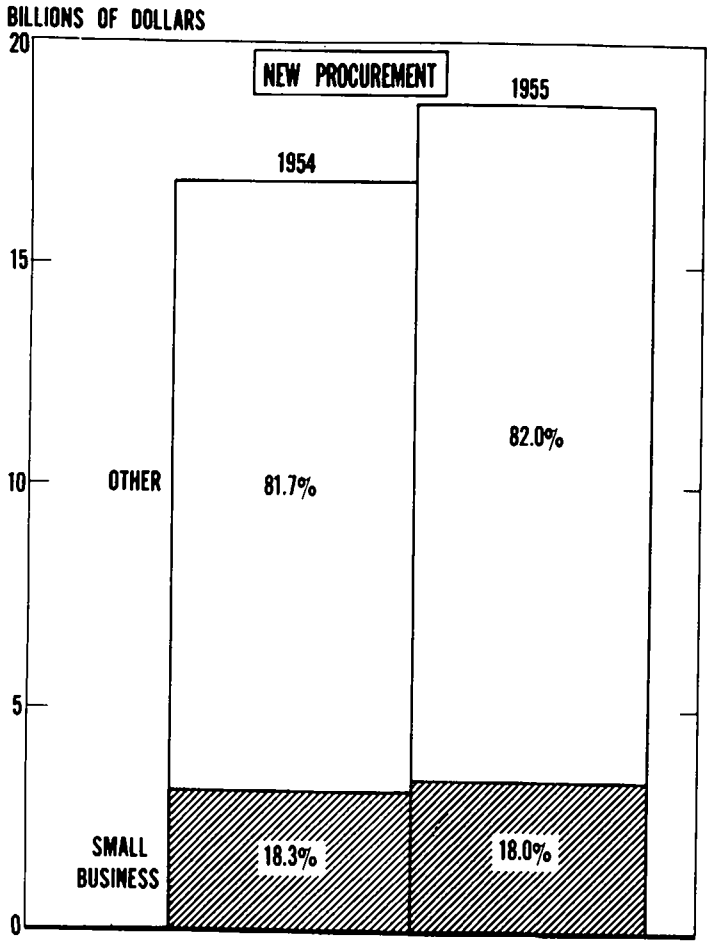
What are the small business problems during mobilization? Well, I would say, and I want to qualify my statement by saying, that, during the mobilization period, in World War II, I was counsel for Douglas Aircraft, and took an active part in the organization of three large Government-owned plants, one at Tulsa, one at Oklahoma City, and one at Chicago. I saw, from the industrial point of view, the problems of a major prime contractor and, I think, also of the Government and of the small business man in dealing with the general problem of using small concerns to their maximum capacity during a mobilization period.

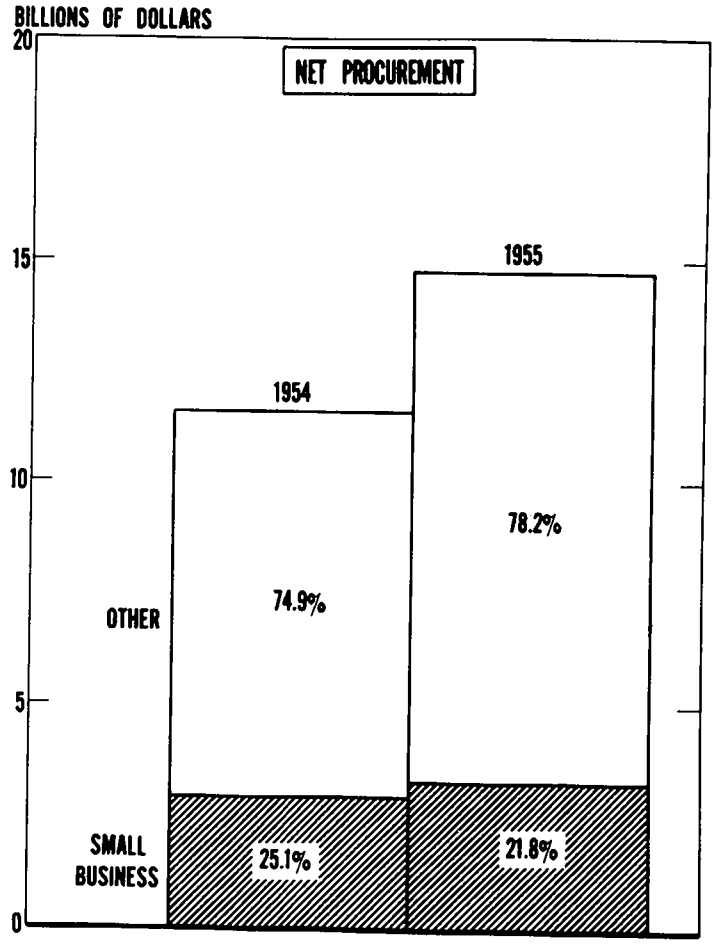
CHART 5

Military Procurement

SMALL BUSINESS SHARE

Fiscal Years 1954 and 1955





SOURCE: Data derived from figures made available by U. S. Department of Defense

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The first general problem, I would say, is that full recognition is usually not given to the capabilities of small business, that is, on the part of the Government, such as determining whether required facilities are available from small firms before granting rapid tax-amortization inducements to expand large firms. The earnings of large companies now show peacetime competitive advantage gained by large companies over small ones by rapid tax amortized facility expansion during wartime. I hear it repeatedly from small firms.

A large firm will expand its buildings under rapid tax amortization and then, after the war, or after the building has been amortized, will put other facilities in the building and compete in that building against a small firm which had, perhaps, the same facilities available prior to the granting of the tax amortization.

We, of course, as Small Defense Plants Administration did before us, work with small firms to try to increase the amortizations that are granted to them.

A second continual problem is one of materials allocation. In a period of scarcity, there is always difficulty in allocating scarce materials to small firms. They usually have not a large staff to keep their problem before the agency that is doing the allocating and usually someone comes up with a panacea, such as, "We will use a historical pattern in granting allocations of scarce material"--the historical purchasing pattern. This puts an immediate penalty on new concerns and concerns that are expanding, and perhaps on the very ones whose brains and talents you want most. So that is a problem.

A third problem is manpower control. That is usually geared to large companies' problems only. Small companies tend to lose out in the competitive race for personnel in wartime.

What are the functions of small companies in a mobilized economy? Well, these are my own observations and those of others on the staff who had time to consider the problem.

1. They may manufacture, as prime contractors, defense items which are not suited to mass production and for the mass-production techniques of the giant companies. Examples: they are multitudinous. There are many types of electronics items needed in such small quantities that mass-production techniques are not the most efficient

way of producing them. There are many types of equipment that, furthermore, require custom development. Those are in perhaps the optical field; they may be surgical accessories, and many things of that nature which may be vital necessities in a period of mobilization.

2. Small firms may manufacture as prime contractors defense items which do not require the mass-production techniques of large companies.

The difference between the two is, the first is items not suited for mass-production techniques; the second is items which do not require them. Examples of the latter are pallets, boxes, various types of packaging, and other items which small companies may manufacture as well as large companies. It is to the advantage of the Government to use the large companies for operations which they can perform best, and use the small companies for operations which they can do, and can do successfully.

3. The third function is to manufacture as subcontractors components, parts, subassemblies, and so forth, for defense items which are being manufactured by large companies as prime contractors.

I hardly need to give you an example of those, but two that might interest you are: General Electric uses approximately 40,000 small businesses as subcontractors and suppliers; RCA uses 6,000. That is the way the aircraft companies operated during the last war. There were 10, 11, or 12 major companies which were prime contract manufacturers of airframes, and their components and subassemblies came from smaller companies.

4. The fourth function is, small companies can manufacture, or continue to manufacture, essential civilian items.

Now, how can this mission of small companies be accomplished in a mobilized economy? Well, one very clear way is the maximum use of the set-aside program which has been developed between the Defense Department and the Small Business Administration, to reserve and set aside prime contracts for small companies. It would merely mean an enlargement of the present program and perhaps the strengthening of it by regulations within the Defense Department and the civilian purchasing agencies, as well as perhaps some statutory increase of authority.

Second, we maintain a facilities inventory, on which small firms list their productive capacity, their machines, their tools, their buildings, the square-footage available, and all that sort of thing. We do it now to call attention to contract opportunities on which they may bid. In wartime this facilities inventory may be screened for suitable small companies to be used as subcontractors by large companies. We have done it very successfully many times, particularly in connection with atomic energy prime-contractors' programs.

Third, small companies may be grouped together into pools to handle larger prime contracts than each one could handle individually. We have authority to do that under our law, and have organized pools, some of which have worked reasonably well in peacetime; but in wartime it is a much more successful operation, because each one is willing to subordinate its own interest for the overall good of the group.

Fourth, financial assistance. (a) Under military contracts the work of small companies can be vastly expanded by the making of progress payments. That is the real key to the maximum utilization of small firms, since most of them in some of their business contracts will require progress payments to be able to perform. (b) Under the essential civilian operation of small firms we can continue to make, as we are doing now, SBA loans through banks and through our own operations.

What do small firms need in a mobilized economy, that they do not expect or do not necessarily need in peacetime? Well, one is technical help. Any small firm working with a large firm--and I saw repeated examples of this during World War II--in order to reach its maximum capacity has to rely on its prime contractor for technical advice, the most detailed technical advice, on plant layout, inspection techniques, materials handling, processing methods, conversion problems, and any help in obtaining personnel and in rationing problems in connection with its personnel, and then in obtaining scarce materials to perform the contract. As a matter of fact, most all the large companies had sections set up to perform each of these functions for subcontractors, and the skill with which they did that affected their whole plan of operation.

It is exceedingly important for the military viewpoint, because, when you have delivery schedules to meet and are dependent on the success of each unit in a long chain, the absence of a few items may, as I have seen it happen, rack up a whole series of aircraft until the

deliveries of the subcontractors are made. The alert contracting officer or administrator for the Government will look beyond the contract date of his prime contractor and will look back into the sub, and sub-sub, and on down into the third and fourth tiers, to see which one of them has facilities to meet delivery dates on a certain item.

Some of the functions of small companies in a future emergency, which I have not mentioned, are: There would be immediate need for small plants to move in to replace large company facilities damaged by attack, by reassigning portions of the prime companies' contracts to an individual firm or a group of small companies. How would this be done? Well, bomb damage would be assessed, and portions of contracts to be reassigned would be determined by others than the Small Business Administration--the Department of Defense, the Federal Civil Defense Administration, the Office of Defense Mobilization, and so forth.

Examples on how this might be performed: Detroit, for instance, would be badly damaged. Other agencies might assess the bomb damage and determine what contracts must be relocated for the success of the emergency effort. When they determine these requirements, when this has been reduced to a crash procurement basis, and when the requirements are spelled out and the military performs its functions of determining requirements, identifying contracts, and identifying the damage that must be covered by relocation of contracts, then SBA would be, and should be, qualified to immediately group together small companies needed to perform the work.

Now, the details of information on small company production capacity would be located by an expanded use of the Small Business Administration's facilities inventory in a future emergency. Here is how we would do that: We are authorized by law now to conduct a business census and to ascertain small companies and the facilities they have that might be used in an emergency. We do not have a complete detailed survey or census of this sort in being. The reason is that it would be perfectly absurd to have it in existence at any one time, because it would be out of date tomorrow. There is a constant turnover. That is a difficulty of the American business picture generally, and perhaps it is even more true of small firms. Any list that was compiled today would be out of date tomorrow. What we must have are techniques to get the information promptly and quickly and have it available when called upon to assist the military in crash procurement.

Here is how we would do it: We would have preselected agencies or individuals in each State to provide promptly, at the outbreak of an emergency, a current list of all the small manufacturers in each State. This is all to be done by those agencies immediately on a prearranged basis. Then SBA would mail a facilities inventory card on which they could list the capacities of each of the companies, to be filled out and returned to our headquarters at a relocation site. Thus we feel that we can very promptly obtain a census of the approximately 400,000 manufacturers by having the system worked out in advance.

When these inventory cards are received--and of course we would not have 100 percent answers, but it would be good, it would be very good, based on past similar activities--the data would then be punched onto IBM cards for rapid selection of facilities by type and for production assignments as above indicated. We would keep a master file in our relocation site with duplicates in each State or regional office, so that we could answer questions on either a regional or a national basis.

What legislation is necessary for this type of emergency procurement service? Well, very little--an emergency appropriation, of course, to start the expanded facilities inventory, and perhaps legal requirements that the inventory data be returned promptly when requested.

In order for us to begin immediately with any such program we need only two things--the SBA does--a contract with the IBM Company for machines and service and stocks of printed forms in readiness. We are in the course of exploring that contract with IBM, and have the forms in effect completed.

What is the present situation? What is the attitude of the military toward this type of future planning? I have been told that I may speak frankly and somewhat controversially, so I will do so.

I have attempted to discuss at various times the need to have a plan in existence outside of SBA which would plan to utilize the productive capacity of the small firms in the country. Roughly, as I said, one-third of the manufacturing capacity is in plants of less than 500. To use them would be of maximum benefit in a period of crash-emergency production. I have been greeted in some quarters--with the statement that probably the next war would be fought with the materials on hand at the time of its outbreak, and that there were certain

rush-emergency projects needed at the present time, and it would be much preferred if we could concentrate on those rather than on a future program which would be of doubtful use by reason of the change in military tactics.

I know that that does not represent the thinking of all of the services and all of the military, but it at least is the greeting that I have had in some places in efforts to make more detailed plans to utilize this large small-business segment of industrial capacity.

I do not think that is too unusual, however. It is easier to deal with large companies in obtaining military procurement. It is less work. You can issue a large prime contract and then leave it to your prime contractor to broaden the base by the use of subcontracts. I don't think that is the full answer, however, because that leads to scarcities of productive capacity and productive facilities.

So long as I am Administrator of SBA we will go ahead preparing a plan such as I have outlined, and have it in readiness and be prepared to have it functioning in about a 10-day to 2-week interval after any outbreak of hostilities that would cause an immediate emergency, and we will do it without the expenditure of any great amount of money.

I think it is time for a break. After the break I will be prepared to answer questions to the best of my ability, at least.

CAPTAIN WRIGHT: Gentlemen, Mr. Barnes is ready for your questions.

QUESTION: Mr. Barnes, I am wondering about those figures you have there on small business, whether they accurately reflect the amount of business that is really generated by defense contracts. I am thinking of subcontracting and contracting, particularly in the service areas. How do you go about determining the real participation of small business in a 35 billion dollar defense program?

MR. BARNES: They do not reflect the entire participation of small business in a defense program. At present there are no figures available on the amount of subcontracting done by small business that are completely accurate.

We have, during the past year, in negotiating with officials in the Pentagon, both from the Defense Department and the services, evolved

three new overall policy statements or regulations. One defines the position or attitude of the Department of Defense and the services toward the small-business activity and their own duties and obligations, and the relations of the Defense Department and the services with the Small Business Administration. Believe me, it is a very cooperative one. It is a vast improvement over anything we had before.

The second agreement relates to the set-aside program and vastly strengthens the activities under that program. To mention only a few changes, whereas in the past it was permissive, and the word "may" was used, that was changed and made mandatory, and the words "shall" and "must" are used. So the contracting officers, in making future determinations, have a mandatory program under which they operate, which will tend to increase the amount of participation. It furthermore places no limitation on the areas in which the program may operate. In research and development contracts, in classified contracts of all kinds, in negotiated as well as advertised bidding, the set-aside program will operate in the future.

That agreement is just now being implemented by regulations being prepared by the services. I have no doubt that another 30 days will see the issuance of those regulations, which will tremendously strengthen the set-aside program in all defense work.

The third agreement relates to subcontracts; it sets up a subcontracting program. It is not as strong a program as we hoped it would be, but it is the first step. In negotiations you sometimes hope to accomplish in your first contract what at the half-way mark you hope to get in your next contract. We think it is a good step in the right direction.

It imposes on all the prime contractors of the Department of Defense today an obligation to create a subcontracting program under the prime contract, to make reports and collect figures showing the extent of the activity, so that, beginning in a few months, or perhaps by the end of this year, we will begin to compile and have available figures on the amount of subcontracting.

That is, needless to say, a big operation, because you know the number and the size of the prime contracts, and this will, we think, be placed in all present prime contracts by change order, and will be inserted as a part of future prime contracts.

That answers your question, I believe.

QUESTION: Mr. Barnes, occasionally in the past few years the minutes of the meetings of some of the Regional Defense Mobilization Committees have crossed my desk. If my memory serves me right, SBA had membership or representation on these committees. If that is true, will you tell me something about what SBA did in those committees, or your functions or reasons for membership on them?

MR. BARNES: What was the name of the committees again?

STUDENT: RDMC--Regional Defense Mobilization Committees.

MR. BARNES: My recollection is that we were invited merely as a courtesy. It was not until there was an insertion in a law passed by the last Congress that the Administrator was officially made a part of certain mobilization committees, ODM committees. We had exercised only an advisory and consultative capacity prior to that time, as I recall.

QUESTION: Sir, I was very impressed with what you are doing to get the small businessman information on specifications and procurement offices, and so on. I have heard small businessmen and procurement officers state that, given information on procurement, the small business man can and will get his share of business without these set-asides or joint determinations. I was wondering if you would comment on that, sir.

MR. BARNES: Well, I can just say flatly that I do not agree, because such problems as this come up. A large company has a staff that it wishes to keep together, and it has made very good profits out of perhaps its civilian work. It has been many times true in the past that it will bid on Government contracts at cost or less than cost, being willing even to take a loss in order to keep its staff together. When you have that type of bidding--and it has been not too infrequent sometimes--a small concern that has been concentrating most of its efforts on defense work is helpless.

There has been a tendency in some areas for large companies to move into fields in which they contributed nothing to the economic growth. I need only to give you an example near here in College Park of the American Car and Foundry Company which purchased the electronic company that formerly made the planes out there--Erco.

There you have a company of which the primary field heretofore has been the construction and manufacture of railroad cars, moving into the electronics field, which was highly competitive, and chiefly the field of many small companies, and doing so to diversify, it is true, but, by reason of its superior financial capacity, being able to move in and disrupt the competitive situation to which it had contributed nothing before that time in its buildup.

So I think that there is an area of set-asides where small companies can compete, where it is an area that is their historical province, which they can do effectively, and which tends to keep the mobilization base as wide as possible.

QUESTION: Mr. Barnes, I am a little at sea as to the value of the financial assistance that the SBA renders, because, if a company can meet the requirements that you have set forth to qualify them for a loan, they are such a good financial risk that any commercial bank would be willing to lend them the money. Would you care to comment on why SBA maintains such high requirements before it will assist with a loan?

MR. BARNES: Yes. In the first place, this is a loan system. If we had lower requirements, it would not be a loan system; it would be something else, some kind of grant, or something. If you are going to make a loan, you expect it to be repaid. While I outline these things that are similar to private lendings, I am sure that there is a flexibility in our program that most banks do not have. Banks have to serve under supervisory authorities of State and Federal Government. They prefer a certain liquidity, usually, in their portfolio. They prefer to have short-era loans. All the banks think you gentlemen do an excellent job in protecting the country and in preparing for emergencies, but they think you are very casual, sometimes, about how you cancel contracts and leave them holding the bag. So they prefer to let you finance your own contracts. They think that you will be less reluctant to cancel a contract in which you have advance payments and your own money; at least you will be willing to help the contractor work out of the situation he finds himself in when the cancellation takes place. Our loans are for larger terms and we do finance Government contracts.

QUESTION: Sir, earlier in your talk you mentioned that one of the handicaps that the small businesses have as against the large businesses is in the field of personnel, technical and skilled help, and so on. Is the Small Business Administration doing anything to propose a system of training along that line?

MR. BARNES: Yes, sir--not the technical personnel--not the engineers and chemists and people that require specialized or almost professional knowledge--physicists, and things of that nature--we think that is an area that belongs in the hands of the colleges. There is very little which we can do to encourage graduates to take notice of the opportunities there are in the small business field.

However, in the field of management, we believe one of the basic problems of a small business owner is to know all of the aspects of managing a business. The large concern has specialists for everything in the world. You have heard of janitors being called maintenance engineers. A small business owner usually is his own accountant, material man, inspector, personnel, and everything else. If he has a small staff, he must conduct those activities on a small-staff scale. Very frequently he will be the owner because he has unusual talents in one line--production, sales, or something of that nature.

We have worked with colleges and universities to have them introduce a management-training course. We now have 86 of those courses in operation across the country in 55 universities. It is a 12-week course. It does not give a Harvard School of Business Administration course, but it is recognized to cover all the aspects of business management. So we recognize the problem and know the worth of skilled professional advice or more detailed information.

QUESTION: Mr. Barnes, do you have any information as to whether the small companies in the metal-working field, the manufacturing group, are less vulnerable than the large so far as location throughout the country is concerned?

MR. BARNES: Well, I don't have any information--I don't know that I have ever seen it collected--but my guess would be that they are more widely distributed and less vulnerable by reason of their location in areas that are not prime targets. I think there are always surrounding a giant corporation, a manufacturing corporation, 300 or more small companies that serve as suppliers, and maybe a great many more that serve as dealers. Every map I have seen prepared by large companies of where their suppliers are shows a wide scattering. So I think the small firms are less concentrated in the metal-working field.

QUESTION: Mr. Barnes, one of the previous speakers mentioned--he is, incidentally, a representative of big business--that one of their

advantages is that they have a legal staff. With respect to your Administration, do you render any legal assistance to small businesses? If so, to what extent?

MR. BARNES: Yes, we do. I want to make clear that in each of our programs we try not to do anything that would tend to divide the business community into large business and small business camps. Only in the set-aside program is there ever any friction, usually. We provide counseling advice on financial matters, and also on these technical matters, production problems, and things of that nature.

We try not to give advice that is available from the professions, such as planning engineers, and things of that nature. We try not to give legal advice if it is available from attorneys; but, in contract appeals and certain matters involving policy, if there is something involved beyond a question, we are willing to consult with them, and even to intervene with the contracting agency as a sort of amicus curiae to present the policy matter or the policy decision which we believe would contain the most equity. Beyond that, however, we do not represent the small company. We will tell them what route to follow in filing their appeal and what procedural matters, such as statutes of limitations and things of that nature, they must be aware of. We try not to substitute for professional advice that they can hire themselves.

QUESTION: Mr. Barnes, would you give us your opinion of the desirability of a graduated corporation tax along the lines of a graduated income tax, to enable small business to maintain a competitive position or to prevent big business from overextension and diversification activities?

MR. BARNES: Well, you can get very quickly into controversial, even political, rounds in talking about that question. I do not like primitive taxation of any kind, myself, personally, and we have some on the books now. You know that. I don't believe that that is the solution to the problem, because I don't believe that bigness per se is bad. It gets you into the antitrust field. In this country I think all of us feel that, if you compete fairly and within the limitations of decent business practices that are not industrial piracy, you are entitled to grow, to expand, as large as you are capable of doing. It is only when you start getting out of your immediate field and using your size to interfere with production in small firms that I, myself, get upset. And that is not always against the law, yet.

The rest remains completely in the antitrust field, and small concerns may violate the precepts of antitrust as well as large concerns. I do not believe that applying graduated income tax to penalize largeness is compatible with the free enterprise system and what we have been led to think of in the past. I think small business must have relief from its present tax burdens, but the way to accomplish hat is to raise the tax notch, the place at which the surtax begins to apply, to make certain there are adjustments that will let them retain their earnings to invest in capital additions, since they do have more difficulty in obtaining equity capital, and since that is a better way than lending to provide for expansion of any type of business.

QUESTION: Mr. Barnes, the military is now being placed in the position of a new concept called Single Service Procurement, or single management, which envisages the collection of all the requirements of the three individual services into one, and then going into the market and procuring those requirements. That will tend to make the size of those requirements much greater than they would be ordinarily. What will be the place of small business in trying to get some of that business, when that business is liable to be too big for any small business to get?

MR. BARNES: It is too big only if it is the type of article that small business cannot manufacture. The fact that there is a large quantity called for does not startle us at all. We have that situation occurring in present procurement. If it is a large production run of an article that small business has traditionally manufactured 50 percent of, or 30 percent of, or 60 percent of, the services will break it into different production runs, different contracts, and give small business a chance to compete on the same share they have held heretofore.

Now, that does not necessarily limit small business even so, because, in competing for the business that is not set aside, they can bid against large companies, so that certain types of articles that they are capable of making, even if they are combined, will not, in my opinion, tend necessarily to reduce the percentage that they may get, providing we keep this set-aside system intact and continue to work with the services in dealing intelligently with each contract, setting part aside and seeing that no price advantage is given the small or large companies, as you know.

QUESTION: Mr. Barnes, this has to do with the small business production boom. In looking at the Joint Committee's report on defense production which was just recently submitted to the House, I noted that since the pool arrangement had been formed about 227 contracts were given, and that, with an evaluation of about 5.8 million dollars, half, 4 contracts totaling 2.7 million dollars, went into default. Can you explain that, please?

MR. BARNES: Yes. I think the pooling method of contracting works well only in wartime, and works only when the pool itself is well organized. I mean, a pool to be able to produce successfully has got to have proper arrangements for scheduling deliveries of material, for inspections, and for flow between plants, and each of the plants must be willing to subordinate its other work to the work of the pool.

Now, in wartime there is a patriotic motivation. There is less opportunity, perhaps, to do certain things in civilian work, due to the scarcity of materials; and for all these reasons the individual members of a pool are willing to subordinate their own interests and to work effectively as a member of the pool.

In peacetime they are always looking for ways to make a fast buck. If they can make it better on a civilian item, they will let the work of the pool slide, unless there is a method of discipline in the pool itself, and unless they have a means of administrative review and planning in connection with all the activities of the pool. That is the reason the contracts have gone bad. We just canceled 17 of the pools out of about 27 because they were not really working at it. It was just something that was in existence, and they were not bidding and had not been too successful in some of their operations. So we canceled them. I don't believe it is a good peacetime method of business organization, except perhaps in certain of the distressed labor areas or some place like that where they are willing to do it.

In conclusion I want to say what a real pleasure it has been for me to be here. We are issuing a semiannual report in about two weeks. There is much material contained in that report that I did not give you here. I merely touched on it lightly, or not at all, because I tried to concentrate more on the functions and activities of small business in an emergency.

If any of you care to be placed on the list to receive copies of our semiannual report, we will be glad to make them available to you.

Thank you.

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