

Small Business Bureau National Conference

THE IMPORTANCE OF small and medium size businesses is best illustrated by imagining what life would be like without them.

The nation's activities would be divided into two groups: large companies on the one hand and on the other, state and local government enterprises.

Management of both these kinds of organisation are similar. Large company functionaries and civil servants come from similar backgrounds. Both chose, early in life, the relative security and specialization offered by big organisations.

If all business activity were concentrated into large and nationalized companies, the prospects for the workforce would also be changed. To sell their skills and their labour, workers could no longer choose between a diversity of potential employers. Their negotiating power would be reduced and would be dwarfed by the power of their only potential employers, the cartels. To seek protection all workers would have to join trade unions with matching power.

So, our society would be dominated by civil servants, cartel functionaries and trade union bosses. They would each militate for greater power in the corridors of government whose activities would become even more extensive.

We would be well on our way to the horrors of the corporate state and then to Marxist Leninism. That is why the preamble to the Small Business Act in the USA which was designed to encourage the development of small business, does not start by stating its economic importance. It starts by emphasising its importance to the security of the nation. That is also why the elimination of small businessmen, whether industrial, commercial or agricultural is central to Marxist strategy.

Indeed, one of Lenin's first acts on obtaining power was to call for the extermination of the Yeoman farmer.

So, it must always be remembered that small business is important even when it remains small. It is a mistake to consider it important only because it is the seedcorn from which new and large enterprise will grow. But the fact that it is the seedcorn is also true and represents yet another reason for the importance of small business.

The lessons of the immediate past are clear and teach us the obvious. Industries grow, mature, and then they decline. Only fools use their resources to prop up the declining. Wise men understand that the true solution is to encourage innovation. Innovation is the child of innovators who are usually rugged and risk taking individuals and are found among small and independent business men. Proof of this is available.

Let us look to the most robust economy of all, that of America. Between 1965 and 1984 the American population aged 16-65 grew by 38% to reach 178 million people. During that same period jobs increased by 45%. Thirty-two million new jobs were created. The number of jobs is still rising fast and it is likely that, by this Autumn, the increase will be almost 50%.

More than half this growth occurred since the energy crisis in 1973 and during the two terrible recessions we have lived through since then. In Western Europe, during that same period, there has been job shrinkage not growth. At the moment there are 3 million fewer jobs in Western Europe than there were in 1974.

Where have all those new jobs in America come from? Fortunately they did not come from government. Alas in Western Europe there has been a steady growth in those employed by

government. In the US, the government stopped expanding its workforce in the early 1970's and has barely maintained it since.

Nor do the new jobs come from big business. Big business has been shedding jobs since the early 1970's. In the past five years alone the largest 500 manufacturing companies in America have permanently lost about 3 million jobs.

Nearly all job creation has been in small and medium size businesses and practically all of it from entrepreneurial and innovative businesses.

It is fashionable nowadays to say that high unemployment will remain a constant feature of our new epoch. The figures for America that I have just quoted show how absurd that is. But this is an idea that appeals to the unenterprising, unimaginative and trendy intellectuals in our society. If only they could understand that freedom works.

In Britain, small business has been systematically and severely damaged. In 1971 the official enquiry on small firms found that in the UK, small businesses accounted for a smaller proportion of output and employment than in any other industrialised country.

Of course, this was due in part to the anti-business and big government ideology of socialism. But not all the blame can be placed on them. The old Conservative Party was profoundly ill at ease with industry, commerce and free markets. For years the intellectuals who created the environment for Conservative thinking, people such as Arnold Toynbee, Arthur Bryant, Trevelyan, Marshall and so many others, were hostile to industrialisation. They variously described industry as philistine, competition as predatory, commerce as debased and considered the whole thing as rather vulgar.

In such a climate, businessmen lost their confidence. At the very moment of its triumph, the entrepreneurial class turned its energies to disguising itself in the image of the class it was supplanting. To be accepted by the Tory hierarchy, successful businessmen went through an accelerated process of gentrification. They became ashamed of the very virtues that created their and their nation's success: toughness, will to achieve, hard work, risk taking and professionalism.

As has been stated before, the nation that had been the mother of the industrial revolution became uneasy with its offspring. Those who had sired industrialization lost their confidence and seemed to wish to deny paternity.

The old Conservative Party adopted many of these values. Despite being the heir of a successful industrialist, Baldwin disliked liberal capitalism and has been called the first of our collectivist Prime Ministers. 'Laissez faire' he said was as out of date as the 'slave trade'.

Macmillan stated that 'Toryism has always been a form of paternal socialism'. Lord Hinchinbrooke, representing the Tory Reform Committee, announced that 'True Conservative opinion is horrified at the damage done to this country since the last war by individualist businessmen ...'. Quintin Hogg, now Lord Hailsham, criticized capitalism as 'an ungodly and rapacious scramble for ill gotten gains ...'.

So the individualist businessman was despised by the patrician Conservative, feared by the socialist and condemned to extermination by the Marxist Leninists. Small wonder that by 1971 the small business sector in the UK was the smallest among all industrialised countries.

The present government is the first to be genuinely committed to reversing this trend and has taken many effective and generous measures. I applaud the effective measures and will comment later on the generous ones.

To prosper, independent businessmen need a free market, free from distortions. Small firms can compete very effectively if they can buy and sell their products in a truly free market

and if they can raise capital on competitive terms. They cannot be expected to prosper if they are forced to buy raw materials and services at higher prices than large companies; or if they are prohibited from selling certain products that their large competitors are able to sell; or if the biggest customers in the land do not want to do business with them and reserve their custom for large companies; or if they have to raise loan capital on terms substantially higher than their large competitors.

All of that is precisely what is happening now, here in Great Britain. I will illustrate this by taking three examples.

Firstly, manufacturers sell to large companies at much lower prices than those they offer to small companies. They justify this by pointing to the buying power of big business. But by offering specially low prices to big companies and selling at higher prices to small companies, they are promoting the constant growth of big business and the steady demise of the small.

Look at the High Street. The large multiple chemists buy at much lower prices than do the independents. What is more, certain product lines are not even available to the small man. The large multiple can have local exclusive franchises for products such as cosmetics which prohibit his competitors from selling them.

So the independent chemist buys his products at a higher price than does his large competitor and often cannot offer the full product range. Under such circumstances, it is not surprising that since 1962 the number of chemists has dropped from 14,600 to 10,700 and that the leading chain of retail chemists now has over 50% of the total market for 'over the counter' drugs.

Now look at my old industry, the grocery trade. The same is true there and with the same results. Since 1961, the market share of independent grocers has dropped from 53% to 22%.

In the retail shoe business, the chains now control nearly 60% of the market.

There is a patronizing and condescending view expressed by the chains. They say, - 'of course, there will always be room for the independents. Their function is to trade during special hours in marginal shopping areas away from the High Street.'

But in reality the independent trader has three enormous advantages over the large chains: personal service for the customers, the commitment of the owner and no need for trade unions. Allow the independent to buy his products at competitive prices, let him sell the full product range and give him access to loan capital on competitive terms and you will see whether the independent's place is only that of a marginal trader. In other words get rid of the anti-competitive distortions and let the small businessman compete on fair terms.

In the USA this was achieved in 1936. A law was enacted called the Robinson-Patman Act. This law ensures that cosy and exclusive arrangements between seller and big buyer are illegal. The aim is not that small business needs an advantage, but that it deserves an 'even break'. Such a law is needed in Britain.

My second example concerns selling as opposed to buying. Unfortunately in 1982 general government spending which includes central and local government, accounted for 55% of the country's gross domestic product. So the State in one form or another is the nation's dominant customer. The people who buy on behalf of the State or who control the buyers, are civil servants. Their tendency is to group their buying so as to deal with fewer and larger customers. They also tend to choose suppliers who are large, well established and therefore, less risky. Civil servants are more comfortable with the functionaries of large business than they are with independent businessmen. An illustration of this is provided by the journalist, Graham Turner in his book 'Business in Britain' in which he quotes a senior ICI executive as saying 'We are very similar to the Administrative Class of the Civil

Service'. So by the nature of things, the State's business goes first and foremost to big business. Small business is the second choice.

In the US, a law exists which calls on government, at every level to make a real effort to do business with the small man and in any case to place with small business a minimum of approximately 23% of total government purchasing. Other countries, including Germany and France give preferential treatment to smaller firms in bidding for government contracts. Some will say that such a law is itself a distortion of the market. But, in reality, it is only trying to compensate for the greatest distortion of all: the fact that the State controls over 55% of the nation's activity. Get rid of that distortion and we would not need such a law. In the meanwhile, lets have one here.

My final example concerns capital, both loan capital and equity capital. Let me start by clarifying the role of the banks. When banks lend, they have to remember that they are lending deposits which are not theirs but which belong to their customers. They are not lending their own capital. They should not use their customers deposits to make investments. It is wrong to suggest that they should take risks which should normally be taken by equity investors, ie owners of the business. Equity should be put up by those whose role it is to invest and to take risks.

So capital is split into two quite different categories: loan capital, which should be reasonably low risk with low rewards, and equity capital which is high risk and which when successful can deliver high rewards. Different sources are needed for these two different streams of capital.

The government has gone a long way to recognising the need for this by introducing the Loan Guarantee Scheme and the Business Expansion Scheme. Both of these schemes are excellent but I believe both can be somewhat improved.

It is wrong that small business, borrowing under the Loan Guarantee Scheme, should have to pay three per cent over the going rate. Three per cent is enormous. During the great period of expansion of the UK economy, the full interest payable on loans was not much more than three per cent. The purpose of such a loan scheme is not only to make loans available but also that they should be available on competitive terms. So, scrap the three per cent surcharge and save the money from other expenditures to which I will refer later.

It is also important to ensure that the banks do not convert all their lending to small business to loans under the guarantee scheme. The banks should do their job as bankers and make reasonable loans to small business on competitive terms. The loan guarantee scheme should only be for exceptional lending and should not just allow banks to avoid making judgement decisions and taking normal business risks.

The Americans have tried to face this problem by ensuring that their state guaranteed loans are higher risk or longer term than is commercially acceptable to banks. Therefore, before qualifying for state guarantees, the loans must first have been turned down by three conventional banks.

The other improvement that I propose is the creation of the often discussed Small Business Investment Companies. These should be investment trusts that invest all their funds in minority positions in small businesses and in loans to small businesses. Investors in the capital of Small Business Investment Companies should be able to invest in the way provided for under the Business Expansion Scheme. And the investment companies should automatically be able to borrow several times their capital under the Loan Guarantee Scheme. So would be created investment trusts with a real purpose.

They should only be allowed to invest in minority positions in the capital of small businesses because we must avoid building up small business conglomerates. The management of small businesses must be significant owners. That is the essence of small business. I can think of few things more awful than small businesses run by functionaries.

Astoundingly, the Business Expansion Scheme is based on an altogether different principle. In a recent prospectus raising funds under the Business Expansion Scheme, I read:

'An individual investor under this Scheme must not at that time be "connected" with the Company (or become connected with it within the next five years if he is to retain the relief). The main rules relating to connection with a company are that:

- (a) an individual or an associate of his must not be an employee, partner or paid Director of the company; and
- (b) the individual or his associates must not control the Company or possess more than 30 per cent of the ordinary share capital.'

What nonsense. The thinking behind this aspect of the law is typical of a disease that has afflicted this nation. For years we have believed that all that is needed is investment in machinery - that machinery is more important than people. We seem to have wanted innovation without innovators, enterprise without entrepreneurs and capitalism without capitalists.

All government sponsored schemes for small business should only be available to companies in which management owns a significant stake in the company.

Earlier when I proposed scrapping the three per cent surcharge on loans, I said that the money could be saved from other government expenditure on small business. That expenditure results from the generous rather than the effective measures taken by government. In its desire to help, the Government is creating a welfare state for small businessmen. It is providing free legal advice, free training, free advisory services, enterprise zones, etc. A report recently published shows that since May 1981 the cost of establishing 8,065 jobs in enterprise zones was £132.9 million or over £16,000 per job. But most of these jobs came from businesses moving from within the immediate locality. The cost per net new job created remains unknown but is much higher. When I tried to work out the overall cost of everything being done, I found it impossible because such subsidies are not channelled exclusively through the Department of Employment or the Manpower Services Commission. The Department of Industry and many other departments, quangos and local authorities are involved. I realise how difficult it is to avoid this sort of mistake in a culture which for years has believed that government can and should solve all problems and that all that is needed to solve a problem is to throw government money at it. Those who do not bend to this cultural nonsense are considered heartless despite the fact that by accepting it, they ultimately hurt the very people they are supposed to be protecting.

The same happened in America. As a result the American Small Business Administration had been described by one of its recent administrators as 'restrictive, costly, ineffective, burdensome, and generally missing the target'. It is described as being 'bogged down in it.<; own growing bureaucracy'. This bureaucracy now consists of over 5,000 people with more than 100 offices. It provides assistance to 20,000 small businessmen. That is one civil servant for four small businesses.

Not long ago there was a survey of attitudes of new technology entrepreneurs in Silicon Valley. They were asked about their views towards the prospect of subsidising new technology companies in order to promote economic development. The vast majority said that it would be disastrous. They pointed out that many new ideas established on the frontier of technology failed to work out. Typically in the US only two out of ten start-ups succeed. Often the reason is that the team doing the work is somehow wrong. In that event the best thing is to bust-up the team so that individuals can go away, regroup and start again. Keeping a small firm together by subsidy could, therefore, impede rather than promote appropriate economic change.

So please do not create a further layer of welfare state civil servants. Small businessmen are the last people in the world to suffer from a welfare state mentality, and civil servants

are not trained to understand small business. If small businessmen need advice, let them go to a professional and pay for it themselves. Please privatise all these services immediately and use the savings to provide loan capital to small business on competitive terms.

This government is the first government since the war which really believes in private enterprise and in a free market. It has started courageously to tackle the two greatest distortions of our society: State control of the nation's activity and abusive trade union power. So much is now known about the destructive powers ceded to trade unions by a succession of weak governments that no more need be said today. Instead, I would like to mention another distortion to our free market which is dimensionally less damaging than either State control or trade union abuses, but which nonetheless is worthy of attention.

I have in mind the pressure groups or magic circles. Wherever you look, from the insurance market of Lloyds, to the other important institutions both inside and outside the City, you find small entrenched groups with very considerable power and which have been considered by government to be the rightful spokesmen for their industry. Their power to regulate their industry is sometimes recognised by government. They usually carry out their proceedings in secret and their rules are obscure and subject to arbitrary change. Edmund Burke, often considered the prophet of the early Conservative Party, once observed that 'Law and arbitrary power are in eternal enmity'. In fact these groups often are not at all representative of their industries, nor of the nation's true interests. They consist of self-perpetuating oligarchs with a strong vested interest to resist change and to protect established privileges. Anybody with arbitrary power to artificially resist change in the market place is the enemy of small business, and indeed of society as a whole.

The power of these groups is sanctified by the superficially attractive but perhaps hypocritical idea that self-regulation is the best form of regulation. In reality, that is not necessarily so. Self-regulation can be the disguise under which these self-perpetuating oligarchs, representing vested interests, preserve their power and give it the appearance of being representative. Those who defend self-regulation talk of its flexibility. Let them visit America, where it is the law that determines issues and not arbitrary power. Let them see for themselves which market is freer and which works best. Compared to theirs, our market is as free as an antiquated chastity belt.

This government has started on the vital and priority task of reducing state intervention and bringing the trade unions back under the rule of law. It should also sweep away the arbitrary powers of restrictive and anti-competitive magic circles whether or not they masquerade as self-regulating committees, quangos, qualgos, councils, quasi-judicial bodies, associations, boards of governors or any of the rest of them.

The government should enact clear legislation which would be interpreted by the courts in a like manner for all; without prejudice and without privilege.

These are the sort of measures that will create a free market, free from distortion and which will liberate for the good of all, the immense latent energies of a free society.

This government has made a magnificent start. It must continue with undiminished fervour.