

THE GRAZIADIO  
Business Report



*Fall 2000*

**In This Issue...**

Building Wealth  
ADA Ruling  
Complex World  
SEC on Disclosure  
Business Portals  
Small Businesses  
E-Biz@GBR  
The LOOP  
Arcade  
Quiz  
Poll

**Send this article  
to a friend!**

Sender's Name:

Recipient's Name:

E-Mail Address:

**SEND**

## How Small Firms Plan to Grow

One-third of firms in survey  
plan to expand globally

**Owen P. Hall, Jr., P.E., Ph.D. &  
Michael Davis, Ph.D., CPA**

**Application: Entrepreneurs are opting for new modes  
of financing and compensation.**

The Internet and other emerging technologies have lowered barriers to business creation and helped to make small businesses the backbone of the American economy. Over the past decade, small businesses (500 employees or less) created nearly all of the net new jobs. Very small businesses (20 employees or less) generated 68 percent of the new jobs. Small businesses employed 53 percent of the private work force, accounted for more than 25 percent of the high tech jobs, and generated 55 percent of the technical innovations.

But two major obstacles have become apparent as small firms seek to grow. One obstacle is that an aging workforce, largely untrained in the use of emerging technologies, has created a shortage of skilled labor. This has become a particular challenge for those small employers who have little more than equity with which to attract qualified personnel. The second is that, while emerging markets and new technologies rapidly propel some entrepreneurial firms to initial public offerings, a shortage of bank financing is driving other firms to non-traditional funding sources. Entrepreneurs are exploring credit lines from investment banks, loans from small business investment companies (SBICs), SBA-guaranteed bank loans, and venture capital relationships. This article presents the results of a recent survey by the authors in which small business owners across the U.S. describe how they plan to grow their firms in the face of such obstacles.

This Internet based survey was distributed to over 2,500 small businesses throughout the country. All firms in the sample have fewer than 500 employees. Figure 1 shows the distribution of respondents by business category.

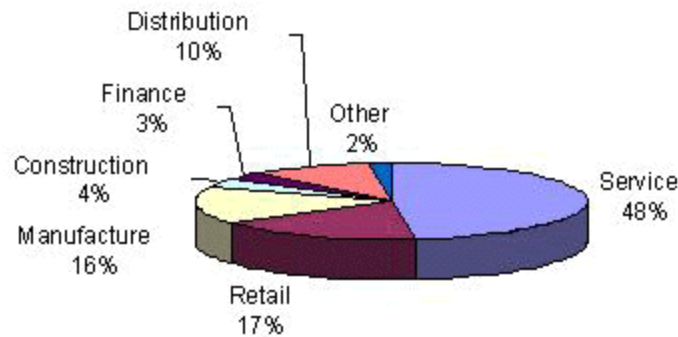


Figure 1 - Respondent Distribution by Business Category

### How Small Businesses Plan to Grow

Sixty-nine percent of the responding firms intend to grow via internal growth during the next five years compared with only 16 percent that plan to grow via acquisition and 11 percent that plan to grow by identifying a global partner. This provides clear evidence that small businesses are trying to expand the "old fashioned way," i.e., by growing their existing business and customers. The majority of the respondents plan to grow their business by "finding more customers similar to the current customer base."

Forty-five percent of the respondents plan to allocate over 15 percent of sales to grow their business over the next five years. The larger a firm's total assets - the smaller the amount (percent) of its resources will be used for growing the business over the next five years. While it might seem natural for smaller firms to spend proportionately more on growth, 21 percent of respondents plan to devote more than 30 percent of revenues to business growth. This clearly sets an aggressive standard.

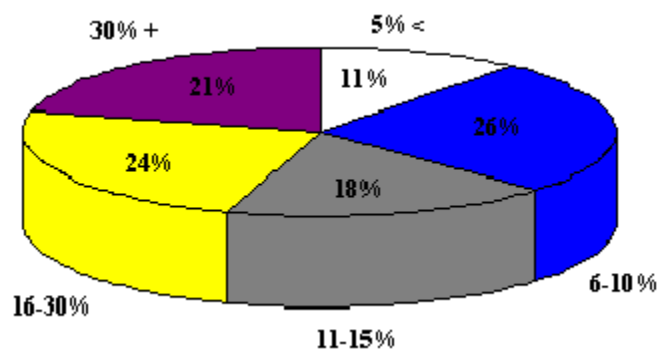


Figure 2 - Percentage of sales to be used for growing business over the next five years

Forty-two percent of the responding firms have no current international sales, and 37 percent have less than 10

percent, so that 79 percent of the sample firms deal primarily or solely with U.S. customers. Only 14 percent of respondents have international sales that account for 11 to 25 percent of their revenues and a mere seven percent attribute 46 percent or more of their revenues to foreign customers. However, two-thirds of the respondents believe that their products or services lend themselves to international markets (see Figure 3). The age of the firm does not appear to impact whether a firm has significant international sales.

A key finding of the survey is that 40 percent of respondents have no intention of increasing international sales and another 24 percent plan on increasing them less than ten percent. The survey strongly indicates that the larger a firm's current international sales, the more it plans to increase its percentage of international sales during the next five years. Apparently, firms with an international presence are leveraging that presence as much as possible. There was no significant relationship between the age of the firm and the likelihood that it will expand internationally.

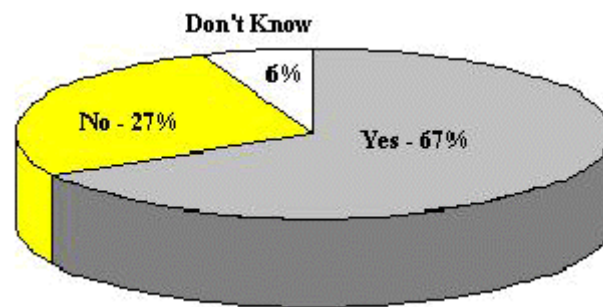


Figure 3 - Does your product or service lend itself to international markets?

The top three motives for growing internationally are "inquiries from international markets," "rapid technological development," and "global markets more promising," respectively. The most promising international markets are (in order):

1. Europe
2. Asia/Far East
3. Latin/South America

### **Firms Face Shortage of Bank Financing and Tight Labor Market**

Small firms are increasingly using funds from

non-traditional sources to finance growth. When computer network consultants Netforce Technologies received a line of credit from Merrill Lynch, for example, the interest rate was lower than bank rates and the company had greater payment flexibility. Small Business Investment Companies (SBICs), privately owned investment firms licensed and regulated by the SBA, are another alternative. Past SBIC loan recipients include Intel, Sun Microsystems, Apple Computer, Callaway Golf, America Online, Staples, Compaq, and Federal Express.

Some small businesses are well positioned to help large, multinational firms serve specific niche markets. In such cases, a large firm can be an additional source of venture capital. Corporate venture funding exceeded \$6 billion last year and accounted for 15 percent of all venture capital invested in small businesses. This compares with only \$1.5 billion, or seven percent, for 1998. Currently, there are nearly 200 corporations with venture capital programs.

Some small businesses benefit from retaining a lean, start-up mentality even while expanding into new products and markets. Denver-based firm EFTC Corp. recognized the need for a supplier capable of processing small orders and now exceeds the industry's annual 24 percent growth rate by specializing in small-lot manufacturing and repair of electronic products. In that field, smaller is better according to EFTC CEO Jack Calderon who says, "He with the least amount of inventory wins." EFTC has maintained its small business model while acquiring a string of other small electronics firms in regional markets across the country.

In response to tight labor markets, entrepreneurs are opting to use innovative benefit packages to attract and retain skilled personnel. Even fast food companies now offer 401(k) programs and free dental insurance to employees. Other alternatives include stock options, training programs, daycare facilities, casual dress, flexible scheduling, telecommuting, four-day workweeks, and free dry cleaning. Personal loans, re-paid through payroll deductions, can build employee loyalty.

The survey strongly indicates that many small businesses have yet to discover global markets. At the same time, firms currently sending goods and services overseas report aggressive plans for further growth in these markets. This suggests that global markets may hold great potential for small businesses in the new economy.

The ambitious growth plans reported by respondents in this survey are consistent with recent research indicating

that entrepreneurs are willing to embrace new technologies, new products, and new markets. It is clear that financing and skilled labor are available to those willing to explore these frontiers, so it appears likely that small firms will continue to be a driving economic force on the road ahead.

---

[Current Issue](#) | [Conversation](#) | [The LOOP](#) | [Back Issues](#) | [GSBM Faculty](#) | [Research](#) | [E-Mail](#) | [GSBM Home](#)

The Graziadio School of Business and Management  
400 Corporate Pointe, Culver City, CA 90230