

# *The Entrepreneurial Economy*

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## **Introduction: from then until now**

The history of humankind has been full of innovation and discovery, but only a few of those innovations have a major impact on the very nature of what one calls “work.”

From the dawn of man until the 19<sup>th</sup> century, most people worked the land. Very early on, of course, technological improvements in agriculture, such as the plow and the irrigation system, allowed farmers to produce enough so that there was a surplus of food. That meant that not everybody had to farm in order to eat, which freed up enough people for the evolution of craftsmen.

Craftsmen produced items like pottery for storage, cloth for clothing, tools to use in working, furniture and furnishings. And, since farmers no longer had to make these things themselves, the quality of their lifestyle improved to some degree. In some ways, it was a perfect market. The craftsmen needed what the farmers grew (for obvious reasons) and the farmers wanted what the craftsmen made (so they wouldn't have to make it themselves).

That's more or less the way it stayed for thousands of years, with one or two wrinkles. Those wrinkles had to do with the development of the organizational structures of society: government, bureaucracy, police and armies, and (eventually) courts. We'll get to them in a bit.

As the population grew, more craftsmen invented more goodies for their fellow humans. In most cases, these were products that people had never had before and had never noticed they lacked. In other cases, they were products that people had had to make themselves but that they could now buy. Sometimes, both goods and services grew out of that unnatural condition known as free time. With the development of labor-saving devices through technology, the drudgery was gradually being lessened from life. Games, toys, entertainment, hobbies — all these early components of the entertainment industry came about because of that wonderful new concept known as leisure.

Back then, standards of living were still low enough that there would have been a ready market for almost anything those craftsmen could come up with that would make people's lives easier. The only problem, of course, was that the peasants on the farms were low man on the societal totem pole. More often than not, the craftsmen's best market consisted members of another relatively new societal

development: aristocrats. That was only natural. Business people generally consider it to be a waste of time to try to sell their goods and services to people who can't afford to buy them.

Population growth eventually posed a problem for those craftsmen, because there are only so many hours in a day and only so many items any one man (or even a man in a shop with several apprentices) can make. That problem was ultimately solved by the invention of mechanized manufacturing during the Middle Ages.

Many people connect early manufacturing to the steam engine, but it had actually been around for centuries by then. Basic machines powered by people or by specially trained animals did everything from roasting sides of beef to making parchment. Real automation came about when producers learned to harness the power of moving water to run their machinery, a technique used by the ancient Romans and retained by Medieval monks long enough to be re-discovered by business people during the Restoration period.

Of course, this type of manufacturing was still pretty small scale and it didn't make any particular change in the nature of work for most of the world's population. The vast bulk of the world's people were still working on farms. "Work" was still what it had been for millennia. People toiled to provide themselves with food, clothing, shelter and a few labor-saving amenities they could make or (if they were very fortunate) buy. Most work involved hard, not to say back-breaking, physical labor for relatively low returns and, by our standards, poverty was the rule rather than the exception.

That's the way things were when the United States of America was born. We were originally a nation of small craftsmen, shopkeepers and farmers. Unemployment was a foreign concept; people worked because they had to in order to survive. For as long as there was land available on which one could stake a claim, there was always a way for a man to support himself and his family.

Probably the biggest difference between then and now is that there was always work, because people needed to wrest their survival needs from the resources at hand, but there were not really "jobs" as we know them today. That perspective was probably central not only to the push for independence among the leaders of the American colonies but to the level of support they received from everyday colonists. Because of the way they lived, independence from the arbitrary dictates of a "mother country" was a natural impulse for them, largely because it was simply a political extension of the way

they lived.

When the steam engine erupted onto the manufacturing scene, it would be difficult to overstate the profundity of the changes it wrought in the way people lived. Mass production changed everything about the relationship between the individual and the economy.

On the one hand, mass production created what British journalist James Burke once called a “democracy of possessions.” When you make lots and lots of copies of a product for little enough money so that many people can afford to buy it, then ultimately everyone winds up with more or less the same stuff. This almost uniformly raised standards of living, but it also created the machinery of our present consumer economy. It is an economy that is absolutely dependent on getting everybody to buy everything; skills like sewing and embroidery, carpentry and woodworking, leather working, canning and preserving, which were once essential survival skills, are now reserved for hobbyists.

At the same time, it transformed us into a nation of employees, with both positive and negative consequences. Being an employee means that one goes from wresting a living from the materials at hand to earning a wage in return for labor performed for someone else. Employees enrich their employers with their labor, which certainly seemed unfair to scholars with socialist and communist leanings. But in exchange, employees were relieved of much of the responsibility for ensuring their own economic self-sufficiency. Over the decades from then until now, being able to make one’s own way in the world has come to mean being able to hold down a job.

This has had a peculiar effect on the collective American psyche. As much as we talk about life, liberty and the pursuit of happiness, most Americans are fundamentally concerned with security, comfort and the accumulation of things. As wages and standards of living improved, the continued functioning of our industrial production/consumption economy has absolutely depended on the ability of producers to convince consumers to buy a wide array of things they did not really need. By most international standards, Americans are overfed, pampered, and self-indulgent. And we’d all like to stay that way.

But, by making our ability to be overfed, pampered and self-indulgent dependent on the acquisition of gainful employment, Americans have essentially given their individual economic power to an entity known to them as their “employer.”

What do I mean by their economic power? I mean the ability of most American citizens to provide for themselves such essential elements of living as food, clothing, shelter, medical care and some reasonable level of recreational activity is dependent on the actions of other people rather on their own endeavors. It doesn't matter how hard and industriously an employee executes their assigned tasks, if their employer decides they are no longer needed then they lose their job. They must find another job, another employment situation to submit themselves to, in order to maintain the lifestyle their previous job allow them to achieve. And their labor enriches others rather than enriching themselves.

Some economic philosophers such as Marx and Lenin foresaw that this situation would eventually lead to insurrection and revolution as workers grew tired of working to make other people wealthy. After a fashion, they were right. There is a revolution in the works but it does not involve removing the entrenched economic kingpins from their thrones. Rather, it involves the decisions of more and more Americans to take back their economic power in the form of launching and operating their own microbusinesses.

## **What is a microbusiness?**

Size standards for businesses in the United States are a peculiar thing. We are perhaps the only industrialized nation in the world without a separate size category for medium-sized businesses. Here, a businesses come in two sizes: large or small. This size standard is driven largely by political expediency rather than by either practical considerations or a true understanding of the particular challenges facing businesses at various points along the size continuum.

Certainly, it is to the advantage of those medium-sized businesses to be considered small by the federal government. It makes all sorts of goodies available to them, including the U.S. Small Business Administration's loan guaranty and equity access programs, preferential treatment in federal procurement (at least, in theory), the intervention of the SBA's Office of Advocacy on regulatory matters, tax rate advantages for both incorporated and unincorporated small business owners, federal grants for research and development, and more. And, because those medium-sized businesses generate jobs and tax revenues, which makes the government happy, and because they are well-organized politically, their probable resistance to having their label of "small business" taken away from them would likely be very effective.

But if one were to step back from the political exigencies of the situation, it should be readily apparent that it is absurd to lump a non-employer business earning \$42,000 a year into the same category with a business employing 450 employees with \$130.8 million in average annual revenues. These two firms would have very, very little in common (except, perhaps, a shared industry or target market), and policy initiatives that would be very useful for the larger "small" business would not be even remotely relevant to the non-employer.

At the same time, while the medium-sized businesses generate economic activity that is as valuable to their communities as it is to their government, they are in a stark minority when compared to those much smaller businesses. This puts the federal government into the peculiar position of working to maintain effective programs that only meet the needs of a small minority of the small businesses they seek to support. If policy makers are serious about supporting small businesses and their place in the

U.S. economy, then it is growing increasingly urgent that they acknowledge the very different needs of very small businesses and respond accordingly.

Because of all this, it becomes useful to separate out a category of small businesses that are truly small and, while they span every industry sector in the economy, share the common challenges of running a very small business. We refer to these tiny firms as “microbusinesses.”

There is a certain amount of disagreement among various interested parties about the definition of a microbusiness, with some contending that the cutoff size should be under five employees and others asserting that the category should include firms with fewer than ten employees. Some are even willing, for the sake of compromise, to go as high as twenty-five employees. Income levels for this category are as difficult to agree upon because revenue levels of very small businesses can vary widely depending on industry sector and target market. Then, too, the more workers one adds to the business, the higher the allowance for average annual revenues will need to be.

So, for example, the Aspen Institute defines a microenterprise as a small business with fewer than five employees and less than \$35,000 in initial capitalization costs. That might be a useful definition except that the Aspen Institute reserves the term “microenterprise” to refer specifically to firms started by low-income proprietors, and they use the term “microbusiness” to refer to enterprises started by individuals in the middle-income group and up. The National Association for the Self-Employed, on the other hand, defines a microbusiness as one which has fewer than ten employees but the organization does not impose any start-up cost or earnings restrictions on their definition.

The impulse to use readily quantifiable business characteristics in order to formulate size definitions is natural but, in this case, it is misleading. What defines a microbusiness is not its size but rather the way in which its size dictates how it operates and the resultant set of challenges its owner faces. So, a better definition of a microbusiness would be void of specific numeric values for either workforce or for average annual revenues. This, we define our subject:

***A microbusiness is a small business in which no one employee performs a single function or task for the business, and all employees (including the business owner) have functional responsibilities in multiple areas of administration, production and management for the business.***

Of course, this definition makes measuring the number of microbusinesses in the country much more difficult. However, it is generally agreed that all small businesses with fewer than five employees fit this description, and most small businesses with fewer than ten employees do as well. Therefore, in the context of this discussion, we will use the fewer-than-five parameters as our working definition of a microbusiness.

Both the advantages and disadvantages of operating a microbusiness are a function of its small size. On the plus size, microbusinesses tend to be lean, frugal operations. This characteristic often makes for better profit margins and permits many microbusinesses to weather economic storms that drive their larger competitors into bankruptcy or reorganization. They are also nimble little businesses that can turn on a dime, which can be advantageous when quick action is required to take advantage of changes and opportunities in the marketplace.

On the other hand, because the microbusiness owner and his employees have multiple responsibilities in the business, everyone's time is at a premium. This is particularly true of the largest group of microbusinesses: non-employers. For these single-person operations, the business owner wears all hats, from janitor to CEO, and the time constraints this imposes work greatly to their disadvantage in the commercial realm.

Why? The reason is that a great deal of what takes place in the commercial realm involves voluminous amounts of paperwork. Whether one is trying to broach the federal marketplace or seeking debt financing or applying for a technology transfer grant or keeping required records for regulatory compliance, running a business often involves quite a bit of administrative pencil-pushing. Microbusinesses have other reasons for electing to eschew federal procurement, debt financing and other standard ways of growing their businesses, but a big part of what keeps them away from these things that are supposed to be helpful is simply the paperwork.

The other operative disadvantage of running a microbusiness has to do with image. It is very difficult for very small businesses to persuade federal procurement officers, potential corporate clients, and sometimes even everyday consumers to take them seriously, for no other reason than that they are as small as they are. Big business and government clients will tend to look at them askance, unable to comprehend how a single person or a three-person operation can possibly produce quality goods and

services. This is particularly true in industry sectors that are dominated by twentieth century industrialization, such as manufacturing. Only professionals and consultants escape the stigma of being too small.

And the problem is compounded for the 54% of U.S. businesses that are home-based.<sup>1</sup> These small businesses have the most serious credibility problems among microbusinesses and that interferes with everything from access to capital to access to markets. For them, image is everything. Indeed, the very language often used to promote home-based business reflects the prejudice against them. “Hewlett Packard started out as a home-based business,” proponents say. “So did Lilian Vernon and Apple Computers.” The implication is that home-based business ownership is acceptable not on its own merits but *only because* home-based businesses can grow into corporate giants. This line of thinking does a disservice to the 40% of home-based business owners who choose to keep their enterprises based in their homes<sup>2</sup>, even when they no longer have to.

By now, it must be very clear that microbusinesses face a unique set of challenges that are specific to them and require policy responses that are not being addressed by the current arsenal of small business support services offered by federal and state governments. And perhaps their greatest challenge is their relative invisibility. The people who chose to run microbusinesses are almost mythic in their embodiment of the American archetype: fiercely independent, almost invincibly optimistic, community minded and frugal, with a never-say-die do-it-yourself approach to their endeavors. Those very admirable traits are the same characteristics that keep them from organizing politically; microbusiness owners are not joiners. And that, in turn, keeps their voices from being heard by those in government who might like to understand their needs and challenges better but who have no way of knowing where to find them or how to reach them.

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<sup>1</sup>Characteristics of Business Owners, 1992 Economic Census, U.S. Census Bureau, Department of Commerce. The Census Bureau did not publish a Characteristics of Business Owners survey from the 1997 Economic Census; the Characteristics of Business Owners survey results from the 2002 Economic Census are due to be released in the third quarter of 2005.

<sup>2</sup>*Home-Based Business: The Hidden Economy* by Joanne Pratt, under contract with the U.S. Small Business Administration, Office of Advocacy, 1999.

That is going to have to change. As we leave the last remnants of the Industrial Age and enter the Entrepreneurial Age in earnest, the mighty microbusiness will continue its ascendancy in the greater scheme of things. There are a number of factors that have been moving the U.S. in that direction over the past thirty years, that have less to do with economic conditions than they have to do with the condition of the workforce in tandem with the evolution of technology.

## Things are trending micro

If you look at the data on business size classes over the last decade of the 20<sup>th</sup> century, you may notice an interesting phenomenon.

Between 1992 and 2001, the number of large businesses as a relative proportion of the overall number of U.S. firms remained fairly stable at a little less than one-tenth of one percent (0.07%). During the same period, however, the percentage of non-micro small businesses declined from 10.3% to 9.9%, while the percentage of microbusinesses (with fewer than five employees) grew from 89.6% to 90.0%.<sup>3</sup>

Parenthetically, most of that growth is in non-employer businesses, which alone comprise 75% of all U.S. firms. Using the same data, the total number of companies in the country grew from 19.4 million to 22.6 million, and 81.25% of that growth was in non-employer businesses.

The middle is slowly thinning.

Nobody seems to know exactly why this is happening, although a few educated guesses based on observation might be appropriate. Some of the decrease in the number of non-micro small businesses has almost certainly come about because successful small businesses are either graduating from the under-500 club or are being acquired by larger businesses. At the same time, some of these larger small businesses have closed their doors, sometimes due to business failures, sometimes due to retirement of an owner without an heir.

At the same time, new businesses are starting all the time but, unlike in previous decades, it would appear that fewer microbusinesses have been growing to the point that they are graduating into the non-micro small business club. The primary reason for this has to do with a conjunction between revenues and technology.

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<sup>3</sup>These statistics on the numbers of businesses in various size classes, compiled from Census Bureau statistics and released in March 2004 by the SBA Office of Advocacy, are pre-9/11 numbers. More recent data on numbers of businesses in various size classes had not yet been released as of this writing, with the exception of a preliminary release on the number of non-employer businesses from the 2002 Economic Survey.

It used to be a given that any small business owner wanting his business to earn enough to ensure his own material comfort would be required to hire people. The reason for that was simple; a single individual, in most industries, simply was not capable of doing everything required in the way of administration, production and sales, to earn enough money to support the business and himself.

Technology has largely changed that. New production methods, which have automated some processes, customized others, and reduced the cost of still others, have combined to allow many owner-operators to produce more without staff. In addition, small business owners find that they can cost-effectively outsource production (usually using domestic manufacturers), obviating the need to build their own production facilities and hire their own employees. And, because so much of the U.S. economy is now in the services sector, in which people sell what they know or know how to do, production costs in many businesses can be kept extremely low.

Computer software, more and less-expensive communications options (such as Voice over Internet Protocol [VoIP] telephone service and electronic mail), the Internet, and e-commerce, have given people the ability to start businesses for relatively little money, and to perform themselves all sorts of tasks for which they might have had to hire employees a generation ago. Thus technology can give them the expertise they might not otherwise have (e.g., accounting and bookkeeping software), and can help them to maintain a round-the-clock selling presence in a worldwide market (e.g., email marketing and a web site).

All this allows the microbusiness owner to earn a moderate income (average annual revenues for non-employer businesses across all industries was approximately \$43,000 in 2001<sup>4</sup>) without the need to hire employees. When these very small businesses find they do need skilled workers to perform services for their businesses, they will often hire independent contractors or turn to their fellow microbusinesses. So, rather than attempting to staff a marketing department, the microbusiness owner may seek out another microbusiness that offers marketing services. Even administrative and secretarial work is often hired out in this way.

Operating like this works nicely for the microbusiness because it lets them avoid the financial,

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<sup>4</sup>U.S. Census Bureau, 2004.

regulatory, administrative and ethical burdens<sup>5</sup> they associate with becoming an employer. It also improves their profit margins, because hiring a microbusiness to provide marketing services is inevitably more cost-effective for them than hiring marketing staff. And it is because microbusinesses can earn a modest living for their proprietors through the judicious use of the available technology and outsourced services that they often elect to simply stay micro. Most of them have no ambition to become “the next FedEx or Microsoft,” as SBA officials are apt to describe the kind of small businesses they like to display as examples of the agency’s successes.

At the same time, the numbers of Americans starting or planning to start small businesses has been steadily increasing. Back in 2001, the *Wall Street Journal* reported that one in ten American adults was either running a small business or trying to get one started; by 2003, the Global Entrepreneurship Monitor reported that the figure had risen to one in eight. Entrepreneurship and small business ownership are becoming much more common and much more attractive to many people, because of a seemingly unrelated set of circumstances that have combined to push them out of the workplace and into their own micro-firms.

**Work has become unrewarding.**

*Mutual loyalty in the workplace, once a staple of the employer-employee relationship, has gone the way of the dodo.* The days of working for 40 years in one company, and then retiring with the gold watch and pension have been replaced by an “every man and woman for himself” workplace ethic. When employees began to realize that the new management styles that really matured in the 1980s meant that they could no longer count on their employers to “take care of them,” they became less loyal to their bosses in self-defense.

Unfortunately, in addition to the increase in job-hopping and consequent cost of employee churn, this increases employee stress by removing an important human element from the world of work.

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<sup>5</sup>Many microbusiness owners state that they avoid hiring employees because they dread feeling responsible for their well-being — predicting that they would be miserable if poor sales forced them to lay off employees, or if they were unable to afford benefits for employees with families in need of those benefits.

Man really does not live by bread alone and, when employers remove the mutual assistance/loyalty from the workplace, the job becomes a cold place where one does nothing but perform tasks for money. Contrary to what some people will say on the subject, there are much more important things in life than money.

***Job security has become a myth.*** One of the things that used to stop people from starting their own small business — and still does stop some older people who were educated to be employees rather than business owners — was the concept of job security. The thinking was that it was better to have a decent, steady job earning a reasonable, steady paycheck than to take a chance on a business venture that might fail and leave its proprietor destitute.

But once the mutual loyalty of the middle of the last century was gone from the employer-employee relationship, job security became an oxymoron. Managers took to firing people not because of poor work ethics or because of inappropriate behaviors, but because the company decided that the employee was costing them too much money. And it was rare for the employee to know in advance that their position was going to be on the block when the axe fell. At this point, many people stay in jobs out of desperation — because they need the money and there aren't other jobs available, or because they need the benefits for health care for a family member. And some of them don't stay. As one micro-entrepreneur put it, "If I'm not going to know from one day to the next whether or not I'm going to have a job, then I'd rather be insecure running my own business than be insecure working for somebody else."

***Employers are demanding more and paying less.*** It says something significant about corporate culture that the gross domestic product has grown by about 8% over the last four years or so, while employee wages have only grown by about 2%. Where has the excess gone? Into corporate profits and, from there, into shareholder pockets. Maximizing profits for the shareholders has become an unalterable rule, backed up by judicial decisions, and corporate executives and managers are perfectly willing to do so at the expense of the wage earners whose toil makes those profits possible.

One of the drawbacks of the huge gains in productivity in recent years is that it has kept the upward pressures off wages and allowed businesses to demand more and more from current employees rather than hiring more of them. The employees are not really in a position to take their skills

elsewhere because the labor market is a buyer's market right now. With about a quarter of working Americans making an insufficient wage to exceed the federal poverty line, it is clear that many companies are run by people who don't even feel a moral obligation to pay their employees enough money to live on. In the labor *market*, people are commodities and at this point in our economic history, they are a dime a dozen.

***Employees are becoming more distrustful of their employers.*** This is particularly true of large employers, and especially since the proliferation of Enron-like corporate governance scandals a few years ago. It must have seemed to those employees to be a slow progression in which the mutual loyalty was gone, then the 40-year steady job and reliable paycheck were gone, the "decent day's pay for a decent day's work" was gone and, once those stories broke, even the gold watch and pension were gone.

The resulting de-humanizing of the workplace has been a sad thing for America's employees. They must be defensive on the job, unable to rely on their employers to value them for the good-employee work ethic they were taught in schools: punctuality, conscientiousness, obedience to authority, and careful following of instructions. They feel out of control of their lives, unable to find time for their pleasures and their loved ones, as they surely are; it is rare that people stop to think about how much control over your life you give someone when you go to work for them and are thus dependent on them for your means of sustenance.

Small business owners, as a group, usually make better bosses from the employee point of view but, for the reasons cited above, small businesses aren't hiring at the volume they once did. Faced with this untenable situation, many people are finding relief in taking their chances on their own small businesses.

**Microbusiness ownership has become more accessible.**

***Technology has lowered the barriers to entry in most industries.*** It used to be a lot more expensive to start a small business, largely because it used to be that nascent businesses either made or sold tangible goods. When you are functioning in a knowledge-based, service oriented economy, in which it is often possible to create a business out of what you know or what you know how to do, start

up costs can be radically reduced.

Even in industries in which one does sell tangible products, new processes allow new entrants into the field without the need of large infusions of capital. In the publishing industry, for example, print runs of trade paperback books have been made much more affordable for new publishers by the advent of print-on-demand technology. This, in turn, has given rise to an explosion of new small presses and self-published authors — often eschewed by old-school industry stalwarts but making quite a hit with book buyers. This has been working for both the small presses and the consumers because the production expenses involved in print publishing are so high that many larger publishers hesitate to invest in seriously promoting new authors, and some don't publish them at all. Consumers have learned that the smaller, independent presses are the place to find new and interesting literary voices, and the small presses benefit by being able to create a place for themselves with the book buying public.

Technology, in the form of the Internet and e-commerce, has also made it possible in many industries for microbusinesses to improve their margins by selling direct to end consumers and cutting out layer upon layer of middlemen. Again, longstanding industry participants (and particularly those middlemen who are being cut out) don't like it, but there is little they can do about it. And that is one major reason why the numbers of women-owned small business and minority-owned small businesses have been growing at such a clip in recent years. The technological progress of the last twenty years has made what seemed impossible for so long into something that is now affordable and, thus, completely possible for a great many more people.

***Technology allows microbusiness owners to create undetectable companies in their homes, which offers attractive lifestyle options.*** The romanticized vision of the high-powered career woman of the late 1980s and early 1990s, who shucks it all in favor of starting a home-based business in order to spend more time with her children, tickled the fancy of many news editors about ten years ago. Unfortunately, that gave rise to many myths about home-based businesses and their owners that persist to this day.

Many are surprised to discover, for example, that most home-based business owners are men and that women, when surveyed, only give “family reasons” as their motive for starting a home-based

business 17% of the time.<sup>6</sup> The popularity of home-based businesses as not only a career choice but a lifestyle choice has only grown in recent years. As employers have grown more demanding and employees are finding themselves pressured to spend more time on work and less time on their personal relationships, many have rebelled against the ever-increasing intrusiveness of the companies they work for.

Then, too, there is much to be said for creating a more holistic approach to one's life, one in which the children can truly see what you do to earn money, can have the mystery taken out of adult "work" by having it take place where they can see it rather than at some mysterious place called "the office." Not that operating a microbusiness or a home-based business is likely to result in working fewer hours; many microbusiness owners say they work harder than ever but they also seem to enjoy it a great deal more. They have the option of including their families in certain aspects of their businesses, and they can be much more flexible about when and how they work.

These trends in sentiment perhaps reached their peak as an unexpected result of the tragedy of September 11, 2001, when so many of those who lost their lives did so while they were at work. For many Americans, the event brought into sharp focus the suddenness with which they could be snatched from this life, and they responded with strong yearnings to spend more time with the people they loved. Even many of those already working from home resolved to be less adamant about working the hours to make the dollars, in favor of focusing on the important people in their lives. At precisely the same time that corporate America was becoming more demanding of its employees, those employees were becoming more inclined to question their values and make decisions about what was really important to them. An untold number of home-based businesses came into being as a result of that realignment of values.

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<sup>6</sup>Pratt, 1999.

## The shape of things to come

On September 30 and October 1, 2004, the SEI Center for Advanced Studies in Management of the University of Pennsylvania's Wharton School of Business convened a meeting to discuss whether the theory of the firm remains a relevant model in the face of the way companies currently operate.

In an article<sup>7</sup> in their email newsletter, Knowledge@Wharton, the Wharton editors make the case for a fundamental change in structural orientation of companies in a new, global economy:

*In the old days, most companies made products out of raw materials and then sent those goods on to their customers. "The traditional theory of the firm is about the unitary, rational actor that more or less controls all the pieces of the puzzle that it needs in order to produce its outputs," says [Paul Kleindorfer, a professor of operations at Wharton and co-director of the school's Risk Management and Decision Processes Center]. But today, he says, global companies like GM or Toyota don't directly control most of their inputs. "Rather, these organizations are a part of a huge set of interlinked networks across the planet.*

Perhaps even more telling is this, from the same article:

*In operations, Kleindorfer sees a vast distance between the traditional theory and current practice. "If you look at the way in which outsourcing has driven the value chain recently, you would see [that the changes have been huge.] Even along a traditional value chain - from incoming logistics and manufacturing to outgoing, outbound logistics, to marketing, sales and after sales support - firms use contracting and strategic partnering rather than direct ownership to manage the value chain."*

It is no accident that professors of business management in prestigious business schools are noticing that global companies are beginning to operate in precisely the same way that microbusinesses do. In both instances, the lure is obvious; by opting to use contracting and partnering to manage the value chain, firms are able to produce output less expensively than they could if they were to own and

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<sup>7</sup>"Back to the Drawing Board: Is the Traditional Theory of the Firm Obsolete?", Knowledge@Wharton, September 22- October 5, 2004, <http://knowledge.wharton.upenn.edu>.

control all aspects of production. The trend toward this kind of lean operation is a matter of improving corporate profits for the big boys, but it is a matter of survival for the microbusiness.

It is also worth noting that there will inevitably be a segment of the contracting market that will fall to *domestic* microbusinesses, as they learn to successfully compete with their counterparts overseas. And, as those large companies source important functions to home grown microbusinesses and become reliant on them for the goods and services they provide, the microbusiness will become even more integral to the healthy functioning of the U.S. economy than it already is.

None of this is to imply that we can expect, one day, that all U.S. businesses will be composed of a relative few corporate behemoths and millions of microbusinesses. There will always be non-micro small businesses, as well as entrepreneurial fast-growth ventures and gigantic multi-national conglomerates. But the trends suggest that the proportion of U.S. firms that qualify as microbusinesses will probably top out at about 95-97% sometime within the next couple of decades. It is also highly likely that contracting may largely replace the traditional concept of “job creation” with which most policy makers are familiar, as larger companies eschew hiring employees in favor of sourcing out.

Within such a scenario, even non-employers create jobs, if one would consider the work they provide for other microbusinesses and independent contractors. In fact, this is in large measure the way that microbusiness owners address their personnel needs, as mentioned above. Rather than hiring sales staff, they seek out independent distributors who work in their field. They don’t hire marketing staff, but they will retain a microbusiness marketing firm that specializes in working with small businesses.

Among microbusinesses and increasingly among larger firms, then, job creation is often masked as the hiring out of business-to-business goods and services to microbusiness providers. This means that policy makers are going to need to come to grips with a new reality when it comes to crafting economic policy. They will need more than ever to understand how microbusinesses function, what their challenges are, what the aspirations of their owners are, and their relative place in the overall operation of the U.S. economy. They will need to reassess the way in which they think of companies, of work, and of jobs and job creation, and they will have to support needed changes in the way employment is measured.

The microbusiness owner hires many employees, each of whom is another microbusiness.

Increasingly, the larger firm will do the same. Rather than trying to entice businesses large and small to hire more workers, policy makers need to focus their efforts on supporting citizens who, in the coming years, will find themselves forced to make the transition to microbusiness owner because it will only be in that form that their former bosses will still hire them.

Chris Hansen, president of the Home-Based Business Council, Inc. and 2003 Home-based Business Advocate of the Year, once said, “There may not always be ‘jobs’ but there will always be work to do.”

More than anything, lawmakers will have to realize that most of what they think they know about small businesses is no longer the reality of how most small businesses operate. The economy is now making a transition from a property-based industrial economy into a knowledge-based entrepreneurial economy. It is important that economic policy keep up with that transition and support it, rather than fight it in a misguided attempt to resuscitate the U.S. economy that was. The transformation will occur whether the federal government creates the best conditions or not — indeed, it is already occurring. The question those lawmakers must ask themselves is what they can do to make these changes less painful for the American public.

## About the author

What if you heard of a woman who grew up in a public housing project in Philadelphia, surrounded by teen mothers and gang violence, herself the product of a single-parent family dependent on welfare?

What if you heard about another woman, who enjoyed all the privileges of an exclusive finishing school followed by an Ivy League university and an exciting career, first in law and then in journalism?

What if I told you that both of those women are Dawn Rivers Baker?

Dawn Rivers Baker is the President and CEO of Wahmpreneur Publishing, Inc., and the Editor/Publisher of *The MicroEnterprise Journal* (<http://www.microenterprisejournal.com>). Her professional memberships include the Online News Association, the Society of Professional Journalists, and Women Impacting Public Policy. She is also the exclusive provider of small business news for the Business Owners' Idea Cafe ([www.businessownersideacafe.com](http://www.businessownersideacafe.com)), and small business expert for Career-Intelligence.com.

The Syracuse (NY) District of the U.S. Small Business Administration named Ms. Baker their 2003 Small Business Journalist of the Year, and she has been selected for annual inclusion in Marquis' *Who's Who in America*® and *Who's Who of American Women*®.

Ms. Baker is intimately acquainted with both the heights and the depths of human endeavor as a result of a life that spans just about every socio-economic lifestyle available in this varied country. She rose out of poverty through education, earning an *A Better Chance* (ABC) scholarship that sent her to Foxcroft School in Middleburg, Virginia. From there, she attended Princeton and Columbia Universities, and went on to work in legal administration for The Atlantic Recording Corporation and for premier Manhattan-based law firm Rosenman & Colin.

Ms. Baker currently lives in the Catskill Mountains of New York State with her husband of more than 20 years and their four children. In her not-quite-spare time, she serves as an ABC Alumnus Advisor for the Goldman Sachs Institute for Entrepreneurial Thinking and as a Member of the Committee on Special Education for her local school district.

With a widely varied background that allows her to view microbusiness trends in the United States from many different perspectives, Dawn Rivers Baker brings insight and dedication to her reporting for microbusinesses all across America.