Basing small on a percentage of the dominant firms in each industry

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Solutions Proposal

Office of Size Standards – The Small Business Administration's Office of Size Standards (SBA-OSS) establishes size standards for all industries. These size standards determine which businesses are sufficiently small to qualify for federal small business programs (set-aside procurements, small business loans, small business disaster assistance, small business research contracts, etc.).

Key Reference Points – For the purposes of debate, two key reference points are noted in this paper:

- The statutory definition of a small business is a firm that is not dominant in its industry
- The size standard established by SBA-OSS for barbershops - $7,000,000

Barbershops $7 Million - The SBA-OSS definition of a small business, as applied to barbershops, is annual revenues of $7 million or less. In other words, barbershops that are small and not dominant in their industry are those having up to $7 million in annual revenues. SBA-OSS, with 40 lawyers applying their complex statistical/mathematical formulas, recently came up with that result. It came up with a similar result ($7 million) for many other categories of small businesses.

Totally Misguided - Determining that barbershops are small businesses if they have up to $7 million in annual revenues is totally misguided, totally lacking in common sense, and totally unacceptable. That definition demonstrates that the application of OSS's incomprehensible mathematical/statistical methodology for determining size standards is totally inadequate and needs to be abandoned.

Typical Barbershop - Based on the everyday experience of going to a local barbershop for a haircut, the typical barbershop may have two to four stations (sometimes more, sometimes less). Those stations will be staffed by two to four barbers on any given day (more on Saturdays - fewer during the week).

Average Revenues $200,000 - For this analysis, we'll use a figure of three barbers on an average day. Give or take a few dollars, an average haircut costs about $15 dollars (range $10 to $25). If each of the three barbers in a typical barbershop serve 15 clients per day (that's a bit high for weekdays, but might be about right for Saturdays), that comes to about 45 haircuts per day for the barbershop. At $15 per haircut, those 45 haircuts generate about $675 per day in revenue for the barbershop. That $675/day in revenue, multiplied by the 300 days or so a year that the typical barbershop is open for business, yields a little over $200,000 per year in revenue for the average barbershop.

35 Times Larger - A barbershop with twice that capacity would have annual revenues of about $400,000. Barbershops 5 times that size would have annual revenues of around $1 million.

Barbershops 10 times that size would have annual revenues of $2 million. Barbershops 20 times that size would have annual revenues of $4 million. It would take a barbershop 35 times larger than the typical barbershop to reach the small business size standard of $7 million.

At Least 100 Stations - To reach the SBA-OSS small business size standard of $7 million, a small barbershop would have to have 100 stations, each station giving 15 haircuts per day, and each haircut costing $15, for 300 days per year.

$70 Million Dominant Size – The SBA-OSS size standard defines a barbershop with sales of up to $7 million as small because it is not dominant in its industry. That raises the question: what size are the dominant barbershops in the barbershop industry? Let's say that a barbershop that is dominant in the barbershop industry is 10 times larger than the small barbershop size standard ($7 million) established by SBA. That would equate to barbershops with $70 million in annual revenues ($7 million x 10).

At Least 1,000 Stations - To be dominant in the barbershop business, a barbershop would require 1,000 stations, each station giving 15 haircuts per day, and each haircut costing $15. That would result in $65 million in annual revenues for a super barbershop that is dominant in the barbershop industry. This preposterous example clearly shows that the SBA OSS's complex mathematical/statistical methodology for establishing size standards for barbershops is off base by at least two-and-a-half orders of magnitude.

Flawed Methodology - If the SBA-OSS cannot come even remotely close to establishing reasonable size standards for a business as simple as a barbershop, what chance is there for the agency to establish adequate size standards for an industry with the breadth, depth and sophistication of the Information Technology industry? The answer is: it isn't very likely that SBA-OSS will do an adequate job in establishing reasonable size standards for the IT industry. In fact, SBA-OSS has issued proposed new size standards that increase the size of small IT firms from $25 million to $25.5 million. That is totally inadequate for an industry wherein the dominant firms have multiple billions of dollars in annual revenues. The same issue applies to other major areas as well, such as telecommunications, facilities management, base maintenance, environmental remediation, general contracting, and so forth. The size standards are too small.

Common Sense Framework - This Barbershop Size Standard Disaster demonstrates that the establishment of size standards needs to be based not on the application of complicated and virtually incomprehensible mathematical/statistical formulas, but on a common sense framework that will enable the SBA-OSS to establish reasonable, understandable and usable size standards. A simple conceptual framework for the SBA-OSS to consider would be something along the following lines: (the percentages stated are for illustrative purposes only and would vary from industry to industry, based small business requirements to achieve competitive viability):

> *Size standards are intended to define the size of small businesses that are not dominant in their industries. In general, businesses that are not dominant in their industries shall be those that do not exceed 20% (the percentage can vary industry by industry) of the size of the large dominant firms in each industry. For example, in an industry wherein the largest 10 dominant firms have annual revenues averaging $25 million, the small business size standard would be $5 million. For industries wherein*

the largest 10 dominant firms have annual revenues averaging $2 billion, the small business size standard would be $400 million.

No Complicated Formulas - In this simplified approach, SBA-OSS would no longer use its complicated mathematical/statistical methodology to define size standards. Instead, SBA-OSS task would shift to defining the size of the 10 dominant firms in each industry, then multiplying that number by 20% (or some logical percentage, based on industry analysis) to establish the small business size standard. Obviously, the figure of 20% as the size for small businesses in relation to the dominant firms in a given industry is just a suggested starting point. The percentage will likely vary considerably, depending on the characteristics of each industry.

Simplified Approach - This approach would greatly simplify SBA's task of establishing size standards, enabling OSS to articulate size standards along these lines:

1. The 10 largest (dominant) barbershops in major metropolitan areas average $2 million in revenues annually. Therefore, the size standard for small barbershops is $400,000 (20% of the size of the dominant firms in that industry).
2. The 10 largest (dominant) CPA firms in major metropolitan areas average $100 million in revenues annually. Therefore, the size standard for small CPA firms is $20 million (20% of the size of the dominant firms in that industry).
3. The 10 largest (dominant) Systems Integration IT firms in the country average $2.5 billion in revenues annually. Therefore, the size standard for small Systems Integration IT firms is $500 million (20% of the size of the dominant firms in that industry).
4.

Comprehensible Methodology - This framework gives SBA-OSS a methodology for establishing size standards that is readily understandable by the business community. This approach would provide all business owners in all industries the ability to understand how the size standards for their businesses were established.

Percentage Varies By Industry - The 20% figure is simply a starting point and is probably not adequate for each and every industry. The SBA's OSS would conduct an analysis by industry to establish the percentages that are appropriate for each industry. Business owners and their advocacy associations could engage the SBA-OSS in discussions about the nature of their industries and why the percentage figure should be increased or decreased for their particular industry. At the present time, it is virtually impossible to have such discussions with SBA-OSS when the mathematical/statistical formulas used by SBA-OSS are virtually incomprehensible to ordinary business people and their advocacy organizations.

Pros
Cons