Down-sizing The Little Guy Myth in Legal Definitions

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ABSTRACT

What is “small” in the eyes of the law? In fact, there is not one standard definition. Current lax legal definitions of firm’s size are inconsistent and overinclusive. They result in data distortion that reinforces favoritism toward small entities as studies on the contribution of small business to the economy are greatly dependent on those studies’ delineation of the term “small.” Therefore, I argue that the current focus on size in legal definitions is a waste of time and money. In this time of huge deficits and rise in economic inequality, a lot of money is being spent based on the entrenched belief that small firms are the essence of our economy, which is not necessarily true.

This paper lays out the policy considerations that underlie the favorable regulatory treatment granted to small firms throughout the law. It provides a comprehensive survey of legal definitions of small entities and concludes that the historical emphasis on magnitude and the creation of legal demarcations concentrated on “smallness” are erroneous. The recent integration of federal commerce and trade agencies is the first step toward this proposed shift from size-centered to goal-driven approach.

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I. INTRODUCTION

In recent years, there has been a growing interest in examining the degree to which small businesses contribute to economic growth. Small entities are regarded as the job engine of the U.S. economy, and are viewed as the source of entrepreneurship and innovation.\(^1\) They represent the essence of the American dream and the free enterprise system.\(^2\) Small businesses—those with fewer than 500 employees—employ about half of the nation’s private sector workforce, and provide half of the nonfarm, private real gross domestic product.\(^3\) In his recent State of the Union address, President Obama stated:

[W]e should support everyone who’s willing to work, and every risk-taker and entrepreneur who aspires to become the next Steve Jobs. After all, innovation is what America has always been about. Most new jobs are created in start-ups and small businesses. So let’s pass an agenda that helps them succeed. Tear down regulations that prevent aspiring entrepreneurs from getting the financing to grow. Expand tax relief to small businesses that are raising wages and creating good jobs.\(^4\)

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\(^1\) See infra Part II.B.

\(^2\) Mirit Eyal-Cohen, Why Is Small Business the Chief Business of Congress?, 43 RUTGERS L. J. (forthcoming 2012) [hereinafter Eyal-Cohen, Why Is Small Business the Chief Business of Congress] [reviewing these justifications at length, and their effect as positive feedbacks that reinforce the path dependence of small business preferences and concluding that those rationales reflect today’s small business culture that reinforces glorification of these entities and the expansion of their preferential legal treatment].


\(^4\) President Barack Obama, State of the Union Address, (Jan. 24, 2012) (transcript available at http://www.whitehouse.gov/the-press-office/2012/01/24/remarks-president-
But just what is a “small” business? Where is the cutoff line drawn between a small business and a medium or large one? Depending on where one looks in U.S. laws, the definitions vary in each area of U.S. law, and they differ from one section to another. During the nineteenth century, a personal relationship between the owners of a firm and the employees was one of the main characteristics that courts looked for when identifying an entity as a small business. Without a clear definition, other courts resorted to the “I will know it when I see it” approach. A small business corporation was defined for the first time in 1947 with the amendment to the Clayton Act, defining it according to the entity’s share of the total national sales. This description did not persist, however, and soon other delineations of small concerns appeared.

Historically, there have been at least three main defining characteristics of a “small” entity. First are the criteria involving an entity’s amount of revenue, sales, receipts, or profits. Second are criteria based on the number of employees. Third, total assets is a measure that has been used in some legislation to separate “small” businesses from

state-union-address) [hereinafter 2012 State of the Union].


6 See, e.g. Andrews Bros. Co. v. Youngstown Coke Co., 86 F. 585, 591 (6th Cir. 1898) (stating that “… small business corporations, where the personnel of the members is a matter of some importance, and is the only feature which particularly distinguishes these associations from ordinary corporations”).

7 O’Harra v. Littlejohn, 69 F. Supp. 274, 276 (D.D.C. 1946) (stating that the legislature never defined a small business and left it up to the administrators of the different agencies to define it but concludes that “it is clear that plaintiff dominates bus transportation in Alaska, and that, for Alaska, his enterprise is a large business.”).

8 38 Stat. 730, 15 U.S.C.S. §§ 12–27, 44, Oct. 15, 1914 (“Small business corporations [are those] whose sales before and after acquisition would not represent 5 percent of the total in their respective lines of trade, either locally or on a national scale.”)

9 26 U.S.C. § 203(s)(1)(A) (stating that a firm with gross sales under $500,000 is exempt from the Fair Labor Standards Act); 21 U.S.C. § 343(q)(5)(D) (stating that firms with total sales to consumers of not more than $500,000 are exempt from the Food and Drug Administration Modernization Act).

midsize and large ones.\textsuperscript{11} Today, the number of employees is the main standard the Small Business Administration ("SBA") uses to define a small business; it considers most firms with 500 employees or fewer to be "small."\textsuperscript{12} This size benchmark is, in effect, a historical remnant of a standard set by the Smaller War Plants Corporation created during World War II in order to urge federal agencies and big businesses to increase the participation of small business in procurement contracts.\textsuperscript{13}

What these typical yardsticks fail to actually assess, however, is the legislative intent and the prerequisite for defining a small concern. The U.S. government has been cultivating the notion that the backbone of the economy resides with entrepreneurial businesses. Consequently, Congress set out to encourage firms that have the ability to stimulate economic growth.\textsuperscript{14} Nevertheless, is supporting "smallness" the best means to this end?\textsuperscript{15} Do small businesses, by virtue of their size, stimulate the economy? It seems that amid the discussion about how to define "small," the primary goal driving those definitions has been essentially forgotten. Consequently, there is a vast disconnect between the government’s perception of small business and the public’s view of who those entities really are.\textsuperscript{16}

Limited scholarly attention has been paid to the contextual conditions that moderate the efficiency of small entities. This paper scrutinizes the circumstantial delineations of small firms, which directly affect our ability to answer the question of whether they are indeed

\textsuperscript{11} For example, the capital gains tax preference introduced in RRA93 is limited to firms with $50 million or less in assets.

\textsuperscript{12} Currently, the SBA generally defines an industrial small business as an enterprise with 500 to 1,500 employees and a small retailer as a business with annual receipts of $5 to $21 million. Furthermore, the SBA size standard can be found in 13 C.F.R. § 121.105 and contains a list, several hundred pages in length, itemizing small business size standards according to the North American Industry Classification System (NAICS).

\textsuperscript{13} Eyal-Cohen, Why Is Small Business the Chief Business of Congress, supra note 2.

\textsuperscript{14} See, e.g., 139 Cong. Rec. S 1593 (Feb. 16, 1993) ("These are high risk seed capital investments. There is no more important capital formation in the life of a business and these are the investments we most need to encourage with a new capital formation incentive…. This is the American capitalist spirit at work. This is free enterprise in its classic, risk-taking form. This is frontier risk-taking…. This is what has made America so prosperous and free. This is the world of direct venture and seed capital investments.").


\textsuperscript{16} Bernard Featherman, Small Business Administrator on Cabinet Is Good First Step, JOURNAL TRIBUNE, Jan. 26, 2012, http://www.journaltribune.com/articles/2012/01/26/columnist/doc4f216bea62300887094896.txt ("The federal government defines small businesses as those with sales volume up to $25 million, and a maximum of 500 employees. While these numbers may sound like large companies, most small businesses really are small.").
effective in stimulating the economy and creating a healthier job market. The paper argues that current legal definitions of small entities suffer from the following problems: First, they are inconsistent and vary from each area of the law and each section within. Second, they are ineffective in allocating government resources and by creating unnecessary litigation and increased compliance costs. Lastly, economic stimulus, job creation and entrepreneurship will not be accomplished by focusing merely on size but by crafting purposive definitions that will target and reward entities according to the activities the government most seek to encourage. De facto, current firms’ size classifications do not identify correctly those entities that indeed stimulate the economy; as not every plumber, contractor, electrician, and lawyer are job creators and the heart of free enterprise.

Part II of the article begins by outlining the policy considerations behind a firm’s size classification and asks the question, “What did Congress intend to promote by granting regulatory relief to small business?” It reveals that economic growth through entrepreneurship, free enterprise, and job creation is the main justification for the preferential treatment for small business. Yet, have we managed to achieve those goals? Part III introduces the myriad small business definitions in various areas of the law and the number of businesses currently encompassed by each definition. It demonstrates that only a very small number of firms truly satisfy all types of small business definitions. Part IV identifies and analyzes three main points of criticism of the focus on size in legal definitions: current size standards defeat legislative intent; are over-inclusive; and result in an ineffective allocation of government resources. Part V concludes that the historical focus on size is flawed. Therefore, other criteria should be considered to achieve the goals we set. A proposed model that replaces the legal emphasis on size will be further explored in a forthcoming article, which introduces a graduated scale of a firm’s entrepreneurial character.

II. POLICY CONSIDERATIONS

Why is our legislation overflowing with so many conflicting notions of size? What accounts for these disparate definitions of small business? To answer these questions, we must first look at the policy considerations for the regulatory treatment of small business. Doing so,

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we find that the main goal that legislators articulate for introducing small business preferences is to achieve economic development.20

The interaction of many variables determines the performance of an economy.21 Exploring the history of small business preferences reveals three reasons why small businesses are believed to spur economic development.22 Small businesses are viewed as the source of entrepreneurship, by creating new products that incorporate new ideas; they are considered the source of job creation; and they are viewed as the essence of the free enterprise system and the guardians of market competition.23 This part will examine those rationales for viewing small business as the engine of economic development.

A. Free Enterprise

In 1953 small businesses across the nation experienced a milestone moment with the enactment of the Small Business Act.24 The act marked the first of many attempts to define the term “small business.” This legislation paved the way for many of today’s small business subsidies and preferences. For the first time, the government manifestly declared a policy directed to advance small entities over other business concerns.25

20 See, e.g., Statement of Senator Dianne Feinstein (D-CA), 139 Cong. Rec. S7952 (1993) when debating adding small businesses provisions to allow them special capital gain exclusion (“I am concerned that this legislation does not include a targeted capital gains exclusion for small businesses… The development of patient capital to aid in the start-up and expansion of small and mid-size businesses is vital to job creation.”).


22 David Deakins & Mark Freil, ENTREPRENEURSHIP AND SMALL FIRMS 28 (5th ed. 2009).


25 Congress provided for some sort of preferential treatment to small entities even earlier, See Louis B. Schwartz, “Justice” and Other Non-Economic Goals of Antitrust, 127 U. PA. L. REV. 1076 (1979) (reviewing a list of small business preferences, such as the Reclamation Act of 1902, which limited the sale of water from federal irrigation projects to a single owner; the Public Utility Holding Company Act of 1935, which relaxed restrictions to large utility firms provided that local firms were left unharmed; the Small Business Act of 1942, declaring a policy to assure “small business concerns [a] fair proportion” of government procurement contracts; and the Surplus Property Act of 1944.
The Small Business Administration was established as the administrative body to execute this policy. What policy has the government sought to promote through this act?

At the onset, the act stated Congress’s policy was to promote market diversity and entrepreneurship, declaring:

The essence of the American economic system of private enterprise is free competition. Only through full and free competition can free markets, free entry into business, and opportunities for the expression and growth of personal initiative and individual judgment be assured. The preservation and expansion of such competition is basic not only to the economic well-being but to the security of this Nation...It is the declared policy of the Congress that the Government should aid, counsel, assist, and protect insofar as is possible the interests of small-business concerns in order to preserve free competitive enterprise.26

Traditionally, “free enterprise” and the “free market” have been salient words in American society.27 These phrases have been grounded in two fundamental principles: that market diversity is the backbone of democratic capitalism and that the market prospers best when business judgments are unfettered by government interference.28

Yet, “free enterprise” is a tricky term.29 Over time, the words “free enterprise” have signified different, contradictory ideas.30 In the past it meant an enterprise system free from monopolies.31 Others view free

giving preference to small purchasers in federal war production facilities.).

26 Id.
27 See, e.g., Statement of Senator Gaylord A. Nelson (D–WI), 124 Cong. Rec. 35198 (Oct. 10, 1978) (“the small business community has always been the cutting edge of the American free enterprise system.... I think it is time that we paid some attention to those businesses who are at the competitive edge of the free enterprise capitalist system. They will produce enormous benefits for the economy if given an opportunity to accumulate capital and grow.”).
28 Harry N. Rosenfield, The Free Enterprise System, 43 THE ANTIΟCH L. REV. 352, 352 (1985) (Arguing that “free enterprise” is merely a talismanic phrase entrenched in political rhetoric but in reality government interference is inherent in the form of corporate welfare and government bailouts.).
29 A.D.H. Kaplan, The Role of Small Business and Free Enterprise, 22 PROCEEDINGS OF THE ACADEMY OF POLITICAL SCIENCE, 17, 17 (1947) (“A comforting quality of our understanding of the term free enterprise is the freedom that has been assumed in changing the definition of the term to suit the time and the particular interests that are involved.”).
30 Frank T. Carlton, What Is Free Enterprise?, 3 AM. J. ECON. & SOCIOLOGY 655, 655 (1944) (arguing that governmental interference with free enterprise is one of the main post-war effects).
31 For example, in the 1940s the phrase reflected a will for minimum government interference. Id. at 656 (“The words ‘free enterprise’ are used today by those who demand a hands off program on the part of government. Free signifies no change or bounds; enterprise places before our eyes a picture of initiative, industry, and adventure.
enterprise as a system free of governmental interference. Free enterprise today means supervised rivalry within antitrust rules. It signifies government interference by regulating business under rules that give, as much as is feasible, reasonable opportunity for rival business groups to persist.

Small businesses have been viewed as both victims and saviors of the free enterprise concept. Politicians have glorified small businesses for being the essence of the free enterprise system. Small business organizations promoted their members as adding to the diversity of the market. Others have viewed small entities as maverick firms, which offer local low-cost alternatives to high-priced leading products produced by giant corporations. The existence of substitute products in the market created by smaller competitors has been regarded as key to

It is a phrase which nearly all Americans are inclined to favor.

Merriam-Webster dictionary defines “free enterprise” as “an economic system having predominantly private ownership of the means of production, and relying chiefly on market forces to allocate goods and resources and to determine prices, and having a minimum of governmental interference in economic decisions.”


Carlton, supra note 30, at 658.

Statement of Senator Gaylord A. Nelson (D-WI), 124 Cong. Rec. 35198 (Oct. 10, 1978) (“That involves these 14 million businesses and small corporations, small businesses, which are the heart and soul of the competitive free enterprise system. We all want this system to flourish and grow. It must be nourished from the roots.”); See also LEGISLATIVE HISTORY OF THE ECONOMIC RECOVERY TAX ACT OF 1981: P.L. 97-34: 95 Stat. 172: August 13, 1981 277 (1981) (“No other nation in the world approaches the aggregate productive output of our economic system. This result is a direct consequence of our free enterprise system which allows every individual to maximize his potential and realize his goals through hard work, determination and the desire to succeed.”).


See, e.g., John L. Orcutt, Improving the Efficiency of the Angel Finance Market: A Proposal to Expand the Intermediary Role of Finders in the Private Capital Raising Setting, 37 Ariz. St. L.J. 861 (2005) (distinguishing between small businesses that are “rapid-growth start-ups” to “livelihood businesses” who start small and are likely to stay small).
preserving free competition. The existence of small business was said to be an essential element of a healthy competitive market.\(^{39}\)

Nonetheless, small businesses have also been regarded as victims of the free enterprise concept; in this view, they struggle to stay afloat in a system dominated by large corporations and harsh competition.\(^{40}\) Smaller firms lacking economies of scale have a greater economic incentive to deviate from firms’ price coordination while sustaining fierce competitive conditions. This harsh competition also places small-business concerns at an economic disadvantage. As a result, many small entities default.\(^{41}\) The massive failure of entities weakens the competitive free enterprise system and prevents the orderly development of the national economy.\(^{42}\) Therefore, the government’s role has been regarded as essential at times to interfere in the market in favor of smaller firms in order to preserve their existence.\(^{43}\) It became a policy of Congress to assist small firms in order to strengthen the nation’s economy and maintain the competitive free enterprise system.\(^{44}\)

Yet in recent years, commentators have started to question the justifications for singling out small businesses for special treatment.\(^{45}\) Some economists have noted that helping out the little guy may be good politics, but it isn't necessarily good economics.\(^{46}\) They argue that small

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\(^{39}\) 131 Cong. Rec. 20494 (1985) (Statement of Rep. Kerry) (“[T]he entrance of a small business into a particular market makes that market more competitive.”).  

\(^{40}\) A Bill to Amend an Act Entitled “An Act to Supplement Existing Laws Against Unlawful Restraints and Monopolies, and for Other Purposes [Clayton Act], Hearings On H.R. 515 before H. Subcom. No. 2 of the H. Comm. on the Judiciary, 80th Cong. 29 (1949) (Statement of Joseph D. Henderson, National Managing Director, American Association of Small Business, Inc.).  

\(^{41}\) For example, many small businesses defaulted for failing to raise outside capital and the government response was to enact a bill to sponsor small business participating debenture programs. 131 Cong. Rec. 20494 (1985) (Statement of Rep. Kerry) (“It is no secret that small businesses...face an inherent disadvantage in private capital markets, which thwarts their growth, and which, I am sorry to say, seems to be growing worse.”).  

\(^{42}\) Between 2006 and 2007, there were 668,177 employer firms births and 592,148 employer firms deaths, resulting in a net change of 76,029 firms with 500 employees or fewer. Table A.9 Employer Firm Births and Deaths by Employment Size of Firm, 1990–2007, Small Business Economy, supra note 3, at 125.  

\(^{43}\) H.R. 7963, P.L. 85-536, 72 Stat. 384, 391, § 8(c), Jul. 18, 1958 (“The Administration shall from time to time make studies of matters materially affecting the competitive strength of small business, and of the effect on small business of Federal laws, programs, and regulations, and shall make recommendations to the appropriate Federal agency or agencies for the adjustment.”).  


\(^{45}\) Alan Murray, Packwood’s Tax-Overhaul Plan Offers Small Firms More Than They Sought, WALL ST. J., Mar. 25, 1986. For the notion of “small business is not beautiful”, see infra notes 113, 122, 247-248.  

\(^{46}\) See, e.g., Hilary Stout, A New Headache: In Health-Care Debate, Small Business Benefits At the Expense of Big—Large Corporations, Facing Higher Costs, Are Souring On Support for Reform—Little Firms, Mighty Lobbies, WALL ST. J., July 21, 1994, at A1 (quoting economists that don’t see much justification in giving small business a break other than lobbying power).
entities’ positive spillovers, if any, are not independently a valid reason to favor them through the legal system. If those entities are productive, economists have observed, they should continue to produce positive externalities regardless of the state of market competition.\textsuperscript{47} Entrepreneurship is one such spillover commonly conflated with small business, but how closely are the two actually related?

\textbf{B. Entrepreneurship}

Entrepreneurship has been commonly equated with small business ownership, which has been used to justify regulatory concessions.\textsuperscript{48} Every so often the small business sector receives attention in the media, academia, and politics because of its arguable entrepreneurial character and significance to the economy.\textsuperscript{49} Congress has also viewed small business legislation as a means to assist entrepreneurs and innovators.\textsuperscript{50} It has further allocated common resources to small business and entrepreneurship, viewing them as interrelated.\textsuperscript{51} But a closer look at recent academic literature reveals that the two concepts are rather dissimilar. What stands behind the term “entrepreneurship”?

Entrepreneurship is a convoluted and obscure term and defining it is surprisingly difficult.\textsuperscript{52} Renowned economist Joseph Schumpeter saw

\begin{thebibliography}{9}
\bibitem{47} George R. Davies, \textit{Laissez Faire and Free Enterprise}, 7 AM. J. ECON. & SOCIOLOGY 401, 409 (1948) (“In many fields of small business, however, competition is extreme and wasteful, and capital earnings are precarious. Particularly in retail stores and small shops, there is generally a wasteful surplus of establishments-duplicative investment as it is called-and profits may be abnormally low in accordance with the law of diminishing returns.”).
\bibitem{48} 133 Cong. Rec. S6599 (Daily ed. May 15, 1987) (Statement of Senator David Karnes) (“The true entrepreneurial spirit thrives in small business throughout this country…. It is their spirit of innovation that provides one of the great driving forces in the American industrial machine … much of the future of America’s economy depends on the ideas of our entrepreneurs in small business.”).
\bibitem{49} Jeff Bailey, \textit{Enterprise: Entrepreneurship, Too, Has Its Economic Limits—Encouraging Start-Ups With Legislation May Hold More Risk Than Promise}, WALL ST. J., Oct. 1, 2002 (“Politicians, academics and many others have increasingly embraced small businesses and the entrepreneurs who start them as our economic saviors. Smaller companies create most of the new jobs, these boosters say.”). \textit{See also}, Deakins & Freel, \textit{supra} note 22.
\bibitem{50} See, \textit{e.g.}, 137 Cong. Rec. E2695 (Daily ed. July 24, 1991) (Statement of Representative Thomas H. Andrews) (“The Small Business Economic Opportunity Act will assist entrepreneurs who have promising plans for starting or maintaining successful businesses but who have particular difficulties in getting those plans off the ground.”).
\bibitem{51} For example, in 1983 the U.S. Senate Committee on Small Business designated a Subcommittee on Entrepreneurship and Special Problems Facing Small Business.
\bibitem{52} William J. Hausman, \textit{Entrepreneurship in the United States: Defining the Field, Its History, and an Empirical Model of Long-Term Trends}, in \textit{COUNTRY STUDIES IN ENTREPRENEURSHIP} 25-49, 26 (Youssef Cassis and Ionanna Minoglou eds., 2006) (“A number of scholars have stressed that entrepreneurship is difficult to define because the subject is so complex and elusive.”).
\end{thebibliography}
entrepreneurs as individuals who possess the ability to combine existing resources in creative ways, while constructing discontinuity. Since then, economists have argued that entrepreneurship has been the key to growth and productivity. It involves new independent business creation and making judgmental decisions about coordination of scarce resources. Others have defined the entrepreneur as one who "attempts to create value through recognition of business opportunity, management of risk-taking appropriate to the opportunity, and through communication and management skills to bring the project to fruition." A survey of researchers and practitioners on the meaning of entrepreneurship found that out of 90 potential attributes most people agreed that entrepreneurship consists of entity creation, acquisition, and integration of resources.

Legislatures seek to support entrepreneurship because entrepreneurial activity often generates important spillovers and positive outcomes to the economy. Indeed, economic historians have identified individual entrepreneurs as a group that has often played an important role in past market growth trends. According to these scholars, while


60 William J. Baumol & Robert J. Strom, *Entrepreneurship and Economic Growth*, 1 STRAT. ENTREPRENEURSHIP J. 233, 237 (2007) ("These individuals recognize the commercial opportunities offered by innovations and transform these opportunities into new products that may improve the lives of all citizens and contribute to increased productivity throughout the economy."); See also Rajshree Agarwal, David Audretsch & MB Sarkar, *The Process of Creative Construction: Knowledge Spillovers,
some entrepreneurial activities are unproductive (such as corporate takeovers, litigation, and tax evasion), there are productive entrepreneurial activities with high growth that contribute directly to economic development by creating new value.61

Researchers have identified four main types of entrepreneurship:62 (1) firms involved in entrepreneurial reproduction that create little new value and no innovation,63 (2) firms that are entrepreneurial imitators that do not create new value but reproduce an existing business activity by creating a new business form,64 (3) valorizing entrepreneurial firms that innovate and produce significant new value, and (4) entrepreneurial ventures that lead to radical change, not only by generating new value, but also by creating whole new industries or sectors.65

This taxonomy of entrepreneurship indicates that while most entrepreneurs may start small, not all small firms create new value.66 As opposed to traditional livelihood businesses that exist mainly in order to provide means of support to the owner and his family, successful entrepreneurial entities take high risks by pursuing novel ideas, and when they are successful, they result in rapid and substantial wealth creation.67 That considerable wealth created by entrepreneurial ventures enhances

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61 Baumol, supra note 54, at 141.
63 See, Paul H. Wilken, Entrepreneurship: A Comparative and Historical Study 70 (1979) (differentiating types of entrepreneurship by the degree of innovation and expansion).
64 Id.
65 Id. For instance, Henry Ford is well known as a nineteen century entrepreneur that who his affordable Model T created the mass production of automobiles and contributed to the growth of cities and suburbs and related industries. See also Charles W. Carey, American Inventors, Entrepreneurs & Business Visionaries 129 (2002). A more recent example is Stanford R. Ovshinsky, an American entrepreneur who founded Energy Conversion Laboratory (later changed its name to Energy Conversion Devices), and developed products such as an environmentally friendly nickel-metal hydride battery (widely used today in laptop computers, digital cameras, cell phones, and electric and hybrid cars); flat screen liquid crystal displays; rewritable CD and DVD computer memories, etc., See The Edison of our Age?, The Economist, Dec. 2, 2006, at 33–34.
the gross domestic product and contributes to the development of the nation’s economy.\textsuperscript{68}

Nevertheless, in the legislative discourse, small businessmen and entrepreneurs have been used as synonyms without distinction.\textsuperscript{69} In order to justify new regulatory concessions, small businesses have been constantly portrayed as the source of innovation and change—firms that by their mere existence generate new value and novel industries.\textsuperscript{70} Size has been turned into a pivotal benchmark to indicate business novelty and positive contributions to the economy.\textsuperscript{71}

One illustration can be found in the late 1970s and early 1980s, when there was a severe economic recession affecting much of the developed world.\textsuperscript{72} In light of this recession, described as “the worst since the Great

\textsuperscript{68} Zoltan J. Acs, Pontus Braunerhjelm, David B. Audretsch & Bo Carlsson, \textit{The Knowledge Spillover Theory of Entrepreneurship}, 32 SMALL BUS. ECON. 15, 16 (2009) (arguing that entrepreneurship creates technological change that is central in explaining economic growth).

\textsuperscript{69} See, e.g., \textit{Federal Tax Policy for Economic Growth and Stability: Hearings before the Subcomm. on Tax Policy of the Joint Comm. on the Economic Report, 84th Cong., 1st Sess. (1955), reprinted in 7 INTERNAL REVENUE ACTS OF THE UNITED STATES: REVENUE ACTS OF 1953-1972 WITH LEGISLATIVE HISTORIES, LAWS AND CONGRESSIONAL DOCUMENTS 150 (1985) (“You say in the case of the entrepreneur, the small-business man, there is this deterrent. Mr. Driscoll. Yes, sir.”); Staff Report Summarizing the Committee’s Field Hearings Held in 1985 on the Impact of Tax Reform and Simplifications Proposals on Small Business, 99th Cong., 1st Sess., reprinted in 60 BERNARD D. REAMS, JR. & MARGARET H. McDermott, \textit{TAX REFORM 1986: A LEGISLATIVE HISTORY OF THE TAX REFORM ACT OF 1986: THE LAW, REPORTS, HEARINGS, DEBATES AND RELATED DOCUMENTS 3 (1986) (“these Senators feel strongly that any current or future tax reform proposals considered by Congress must strive to preserve the incentives for small business entrepreneurship contained in the current tax code.”); Impact of Tax Reform and Simplification Proposals on Small Business - Part I: Hearings before the Senate Committee on Small Business, 99th Cong., 1st Sess. (1985) [Jan. 9; Feb. 13, 14; Mar. 4], reprinted in 12 BERNARD D. REAMS, JR. & MARGARET H. McDermott, \textit{TAX REFORM 1986: A LEGISLATIVE HISTORY OF THE TAX REFORM ACT OF 1986: THE LAW, REPORTS, HEARINGS, DEBATES AND RELATED DOCUMENTS 299 (1986) (“I also will say that the Federal Government has enacted legislation within the last 5 years that I feel has been most helpful to the small business entrepreneur, such as the reforms of the subchapter S legislation, the estate tax law, the passage of the Export Trading Company Act, the Prompt Payment Act where the Government has to pay the small business person that has done business with them, and then the greatest of all is the accelerated cost recovery system.”).

\textsuperscript{70} 131 CONG. REC. 20494 (1985) (Statement of Rep. Kerry) (“I am cosponsoring this bill because it encourages such entrepreneurship and risk-taking and gives small business a chance to grow and compete in an economy that is sometimes unfairly stacked against them.”).


\textsuperscript{72} MANSEL G. BLACKFORD, A HISTORY OF SMALL BUSINESS IN AMERICA 166 (2003).
Depression of the 1930s, the U.S. government made efforts to battle high inflation rates and encourage economic growth. Among those efforts was the enactment of the Economic Recovery Act of 1981. The act, also known as the “Kemp-Roth Tax Cut,” amended the Internal Revenue Code of 1954 by reducing individual income tax rates, allowing expensing of depreciable property, and providing incentives for small businesses. Discussing the benefits of the act in the Senate Finance Committee, representatives reinforced the axiom that small businesses are inherently innovative and entrepreneurial:

The importance of small business to the nation and the American people cannot be overstated. Through the drive, creativity and spirit of individual entrepreneurs, the economy of this great nation grew from its simple agrarian beginnings to the most dynamic and diverse economy in the world … This economic diversity is achieved to a great extent through the efforts of entrepreneurs whose small businesses encompass a substantial sector of the economy.

The observation that small businesses are entrepreneurial became repeated rhetoric on the congressional floor. For example, Representative Jack Buechner (R-MO) noted while supporting the enactment of a reduction in the capital gains tax rate:

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73 Id.
76 The act was named after the act’s sponsors, Representative Jack Kemp (R-NY) and Senator William V. Roth, Jr. (D-DE).
78 Id.
Mr. Chairman, the essence of both a growing economy and a dynamic society has been known for almost 90 years, ever since the late Austrian economist, Joseph Schumpeter, identified innovation as the driving force behind economic growth, and the entrepreneur as the agent behind innovation. For it is the entrepreneur who moves resources from the old to the new, and from the obsolete to the productive. But unfortunately, it is the entrepreneur and the small businessman who suffers the most from our adversely high taxes on capital gains.\footnote{135 Cong. Rec. 22234 (1989) (Statement of Rep. Jack Buechner).}

Rhetoric aside, there is no direct correlation between the size of a business and its entrepreneurial character. New research shows that small businesses are mainly skilled craftspeople, professionals, shopkeepers, and restaurateurs that are responsible for little innovation or new value.\footnote{Martin A. Sullivan, When Should Small Businesses Get a Tax Break?, supra note 23.}

Once established, those small firms do not wish to grow or are not expected to grow.\footnote{Id. (“Once they are established, they do not grow. Moreover, they do not want to grow. One major reason for this is that many small business owners are motivated by non-pecuniary benefits such as wanting a flexible schedule or to be their own boss.”)} Thus, it is clear that small businesses that happen to be entrepreneurial are not so solely by virtue of their size. Over the years, many federal and state economic development plans have erroneously ignored the distinction between entrepreneurial and conventional small businesses.\footnote{Eleena De Lisser, Update On Small Businesses States’ Aid for Tech Start-Ups: More Talk Than Action, WALL ST. J., Jan. 4, 2000, at B2 (“The hot technology start-up with no profits but a bright future is lumped into the same small-business category as the family-owned grocery store.”).}

That conflation of small businesses and entrepreneurs has hampered the precise goal of promoting entrepreneurship because the regulatory relief small business owners receive does not necessarily match the support essential to entrepreneurs.\footnote{Id.}

The next part will examine a similar flaw made in connection with another policy consideration for supporting small business.

C. Employment Expansion

Another factor that promotes economic development is job growth.\footnote{See, e.g., Lynda Tran, Unions and Employment Growth: Do Unions Increase Unemployment in Industrial and Developing Countries?, 11 GEO. PUBLIC POL’Y REV. 17, 29 (2005) (“The underlying assumption of this paper is that increased employment aids economic growth in both industrial and developing countries.”). See also, State of the Union, supra note 4. (“We have to seize it. Tonight, my message to business leaders is simple: Ask yourselves what you can do to bring jobs back to your country, and your country will do everything we can to help you succeed.”)} Small businesses, particularly, have been depicted as job creators across...
industries and sectors more than any other type of business. This description derives from the fact that when a business is created, it engages the people employed in the entity, avails work to its owner, and provides capital and labor to its suppliers and its surrounding entities. A European small business scholar described the cause for the belief in small business as job creators:

When a steelworks closes or--more typically--a large defense industry contractor shuts, it is the small firm sector which is seen as the source of new employment opportunities for the redundant workforce. Former unskilled employees become self-employed taxi drivers, window cleaners and small garage employees. Draftsmen, precision engineering fitters and computer specialists become self-employed in their own trades. Where major job shedding takes place, the small firm sector is seen to be the way in which the local economy can create its own employment by 'pulling itself up by its own boot-straps.'

This depiction seems to confuse young firms with small one. But the notion that small businesses are the creators of most net new jobs has been further cultivated by the Small Business Administration, which constantly reports that businesses with fewer than 500 employees account for almost half of all gross revenues generated by U.S. businesses, employ half of all private-sector workers, and generate half of the nation’s real gross domestic product. Overall, according to these reports, between 1993 and 2008, small firms with fewer than 500 employees accounted for 64 percent of the net new jobs.

In recent years, the fervor to explore the sources of job growth has

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85 See President George W. Bush, State of the Union Address, (Feb. 2, 2005) (transcript available at http://www.whitehouse.gov/news/releases/2005/02/20050202-11) (“To make our economy stronger and more competitive, America must reward, not punish, the efforts and dreams of entrepreneurs.... So we must free small businesses from needless regulation and protect honest job-creators from junk lawsuits.”); See also Donald Bruce et al., Small Business and State Growth: An Econometric Investigation, SMALL BUSINESS ASSOCIATION OFFICE OF ADVOCACY (2007) (observing that small firm establishments had a greater impact on state-level output, employment, and income than any other policy option); See also Bernard Featherman, Small Business Administrator on Cabinet Is Good First Step, JOURNAL TRIBUNE, Jan. 26, 2012, available at http://www.journaltribune.com/articles/2012/01/26/columnist/doc4f216bea62300887094896.txt (“While these are good ideas, we need immediate, positive actions to create jobs and improve the economy.”).

86 David Birch et al., Who’s Creating Jobs?, p. 7 (1994), available at http://www.nationalaffairs.com/doclib/20080708_1981651whocreatesjobsdavidbirch.pdf (“Smaller businesses more than offset their higher failure rates with their capacity to start up and expand dramatically.”).


88 Small Business Economy, supra note 3 at 2.

invited much attention to the role that small businesses play in generating employment.90 Small business lobby groups such as the National Federation of Independent Business have endorsed the notion that small business is tightly connected to positive labor trends.91 When advocating for tax breaks, the Chamber of Commerce voiced a similar opinion, stating the importance of small business as the backbone of the nation’s labor production and the economy.92 And lastly, some professionals have also confirmed the view that employment expansion is dependent upon the welfare of small businesses.93

Following this general support, congressional representatives have repeated the depiction that small business is the nation’s job creator.94 “Put simply,” one congressman noted, “small business is the engine which drives our economy.”95 Because of these beliefs, politicians have

90 David Neumark, Brandon Wall & Junfu Zhang, Do Small Businesses Create More Jobs? New Evidence for the United States from the National Establishment Time Series, 93 THE REV. OF ECON. & STAT. 16 (2011) (Finding that small firms create more jobs, on net, although the difference is much smaller than other studies have suggested.)

91 BERNARD D. REAMS, JR. & MARGARET H. McDERMOTT, TAX REFORM 1986: A LEGISLATIVE HISTORY OF THE TAX REFORM ACT OF 1986: THE LAW, REPORTS, HEARINGS, DEBATES AND RELATED DOCUMENTS 498 (1986) (“[O]ur employment policies must include encouraging and increasing the number of small businesses that employ people. If we eat the goose today, it is going to be terribly difficult to have omelettes for breakfast tomorrow. Small business economic growth is inextricably tied to labor costs…The major goal of our economy, given our trade and budget deficits, must be to increase the number of people working. To accomplish that, our employment policies must include encouraging and increasing the number of small businesses that employ people.”).


95 Id. See also Hearing before the Sen. Comm. on Finance, 99th Cong., 1st Sess. (1985) supra note 69. (statement of Sen. Jia Sasser, Member, Sen. Committee on Finance) (“Perhaps the most startling proof of small business’ job generating capacity was seen from 1980 to 1982. During that period, small business accounted for all the new net jobs in the United States. While small business generated 2.6 million jobs during this
endorsed various forms of regulatory relief for small business, proclaiming that this type of legislation will have a large effect on the labor market. When opposing the Worker Adjustment and Retaining Act, Senator Orrin Hatch (R-UT) stated:

The bill raises the risk threshold for small business. The growth in employment in the U.S. is occurring primarily in small to medium sized firms, legislation which affects the ability of small businesses to exit from the market, or cut their costs will have an adverse effect of future employment prospects.  

Yet, new research demonstrates that it is start-up companies, not necessarily small businesses that create most new jobs. Some studies provide evidence that employment dynamics seem to be the same across firm size. They indicated that while small firms and small establishments create more net jobs, the difference is much smaller than what has been suggested. Others argue that the belief that small firms are major contributors of new jobs is largely based on methodological flaws.

period, big business was losing 1.6 million employees.”).

S. REP. ON S. 538, 100th Cong. (June 2, 1987) (the minority views of Sen. Hatch particularly illustrate this point).


Michael Rizzo, Small Business and Job Creation, THE UNBROKEN WINDOW, (Feb. 15, 2010), http://theunbrokenwindow.com/2010/02/15/small-businesses-and-job-creation/ (“What is this chart telling us? It is telling us that net employment dynamics seem to be the same across firm size. While conventional wisdom (indeed Presidential rhetoric) tells us that small businesses are the engines of job creation, a little more nuanced view of the world is perhaps in order.”).

Steven J. Davis & John Haltiwanger & Scott Schuh, Small Business and Job Creation: Dissecting the Myth and Reassessing the Facts, NBER Working Papers 4492, National Bureau of Economic Research, available at http://ideas.repec.org/p/nbr/nberwo/4492.html (arguing “regression fallacy,” that is temporary fluctuations in size systematically biases estimates in favor of small firm job creation.). But see Per Davidsson, Leif Lindmark & Christer Olofsson, The Extent of Overestimation of Small Firm Job Creation – An Empirical Examination of the Regression Bias, 11 SMALL BUSINESS ECONOMICS 87, 87 (1998) (arguing that “there may be good reasons to question to what extent small firms can lead economic development, and whether it is good or bad if they do create most new jobs, but concern for the ‘regression fallacy’ does not seem to be an important issue in this context.”). See also
While in the past, Start-ups, young firms, and mature firms were all lumped together, new data on job growth interrelated to firm age proves that “youth, not smallness, is the key to job creation.”

Moreover, academics have also observed that employment in small firms is generally unstable and unskilled. Most small businesses, scholars have contended, are “livelihood businesses” such as the corner bakery or the local hair salon, which are not entrepreneurial in their character. Some data has even demonstrated that these livelihood businesses are the largest "destroyers" of jobs due to rapid job turnover, layoffs, and frequent bankruptcies and are often described as "job churners." Likewise, some critics maintain that the quality of the employment in those livelihood businesses is usually low paying and lacks job security, benefits, and opportunities for advancement. Therefore, it is clear that small entities do not promote job growth solely by virtue of their size.

Martin A. Sullivan, Start-Ups, Not Small Businesses, Are Key to Job Creation, supra note 97 (“This problem, common in statistical analyses looking at data over time, results in an inverse relationship between size and growth (in this case, a relationship in which small firms grow faster than large firms) even when they are independent of each other… When economists correct for this bias, they find the amount of small firm job creation is not as large as the unadjusted data suggest. And in some industries, small firms have no extra job growth at all.”);

100 Id., John C. Haltiwanger, Ron S. Jarmin, & Javier Miranda, Who Creates Jobs? Small vs. Large vs. Young, NBER Working Paper No. 16300 (August, 2010), http://www.nber.org/papers/w16300.pdf cited in Martin A. Sullivan, New Research Weakens Case for Small Business Tax Relief, supra note 97 (Concluding that there is no systematic relationship between firm size and growth. The study found that it is the youth of small firms, not their size per se, that is creating jobs. Mature small firms have a negative effect on job creation.)

101 Martin A. Sullivan, When Should Small Businesses Get a Tax Break?, supra note 23 (arguing that large firms pay higher wages, provide better health and pension benefits, and have lower turnover than small firms).

102 Id. John L. Orcutt, Improving the Efficiency of the Angel Finance Market: A Proposal to Expand the Intermediary Role of Finders in the Private Capital Raising Setting, 37 Ariz. St. L.J. 861, 863 (2005) (“For example, owner-operated convenience stores, suburban construction companies, or hair salons would fall under the livelihood business classification. These livelihood businesses, which account for more than 90% of small businesses, are not the entrepreneurial force that drives the economy nor are they particularly strong job creators.”).

103 Id. See also The Small Business Economy, supra note 3, at 3 (The Small Business Administration admitted that “small firms lead when the economy is gaining jobs, in some recessionary periods they experience greater job losses when the economy is shedding jobs. As the recession deepened in 2009, particularly in the first quarter, small firms accounted for almost 60 percent of the job losses. But the picture improved as the year progressed. By the third quarter, net job losses in small firms were down by two-thirds.”).

104 Orcutt, supra note 38; Martin A. Sullivan, When Should Small Businesses Get a Tax Break?, supra note 23.
D. Other Considerations

There are other social policies that policymakers seek to promote through the law. Fair labor practices, a safe and clean environment, public health, and reduced paperwork are just a few of those goals. There are other social policies that policymakers seek to promote through the law. F	air labor practices, a safe and clean environment, public health, and reduced paperwork are just a few of those goals.105 In the past half century, advancing racial justice and minority rights have been on the government’s agenda as well. Various studies reveal that minorities find it harder to move up the social ladder and achieve economic independence.106 Minority groups are often refused work and have difficulties obtaining loans from traditional lenders because they are considered to have a greater risk of failure.107

An important mechanism the government utilizes to promote minority groups is small business regulation.108 Boosting minority hiring within government agencies, investigating racial discrimination, and developing minority small business programs are some of the paths that have been taken to promote disadvantaged groups in society.109 In view of that policy, government agencies altered their approach to small businesses, shifting from a neutral stance to fostering minority business ownership.110 Small business regulation became a government tool to improve minorities’ economic participation in the community and to counter the effect of local efforts to establish race-neutral policies.111

106 See Ying Lowrey, Race/Ethnicity and Establishment Dynamics, 2002-2006, Table 1, Small Business Administration, Office of Advocacy (2010), http://archive.sba.gov/advoc/research/rs369tot.pdf (showing that in 2002, the unemployment rates were Blacks-10.2%, Hispanics-7.5%, Whites-5.1%, Total-5.8%).
109 Deakins & Freel, supra note 22 at 53.
110 For example, the Women’s Speaker’s Bureau and the Office of Minority Development Agency are some example of institutions created to help blacks, Mexican-Americans, Puerto Ricans, Native Americans and others become businesspersons and offer incentives for corporations to locate plants in urban slums. See Grants and Loans, U.S. Department of Commerce, Minority Business Development Agency, http://www.mbda.gov/main/find-grant-and-loan-info.
111 In light of several court decisions, supporters of race-neutrality ideology in the U.S. succeeded in convincing several local and state governments to eliminate their affirmative action programs. Increasing small business regulation has become federal
Yet, it is evident that not all small firms are engaged in minority advancement. In fact, studies have found that while women were associated more often with smaller ventures, there were no differences in the representation of minorities between the smaller and larger start-ups.\textsuperscript{112} Other studies showed that small firms tend to engage in much more discrimination than their larger counterparts.\textsuperscript{113} Consequently, the focus on business size as a means for promoting minorities seems questionable. If indeed the federal government wishes to encourage employment of minorities, a direct approach targeting these individuals could be a more efficient alternative.\textsuperscript{114}

One of the biggest concerns for small business is the heavy regulatory burden that results in high compliance costs. Small entities are subject to disproportionately greater compliance costs.\textsuperscript{115} For example, tax complexity has been considered one of the highest compliance costs that small businesses face.\textsuperscript{116} These elevated compliance costs are inherent to small firms’ existence due to the factors of economies of scale and risk management, which work to the benefit of large entities.\textsuperscript{117}
Therefore, some regulatory relief is granted to firms according to their size for administrative reasons. An examination of this broad policy consideration in connection with small business would be an extensive project that has been discussed at length elsewhere.

Lastly, the small business ethos is deeply rooted in the history of the American nation and its democratic tradition. Thus, the importance of small business in our society has also historical and public choice angles. And there is a political and rhetorical value to invoking small business arguments. It may be that some of those stated goals are window dressing for other objectives. It is conceivable that politicians and policymakers promote small business legislation and cite those entities as drivers of economic growth for their political value. Because small businesses have become, in essence, embodiment of an American ethos, politicians use these entities to elicit a positive image in the minds of voters. This theory may be beneficial in explaining why there are few incentives for congressional representatives to significantly curtail the definition of small entities and why politicians would not consider the current imprecision or overinclusiveness problematic.

 enterprise capitalist system. They will produce enormous benefits for the economy if given an opportunity to accumulate capital and grow.

For example, in bankruptcy law a “Small Business Debtor” is defined as a person with debt that does not exceed $2,343,300. Bankruptcy Reform Act of 1994, 11 U.S.C. § 101(51D) (2012) provided that this amount will be adjusted every three years to reflect changes in the Consumer Price Index. An accelerated procedure sought to enable small business debtors to maintain a higher proportion of their assets and to save them administrative costs and compliance fees. The National Bankruptcy Committee declared that it considered debt level criteria appropriate to predict complexity of bankruptcy cases. It found that cases with lower debt levels usually had either no appointed creditors’ committee or had an inactive creditors’ committee. 1 NA'T. L. BANKR. REVIEW COMM’N, FINAL REPORT, BANKRUPTCY: THE NEXT TWENTY YEARS 55, 634-35 (1997), available at http://govinfo.library.unt.edu/nbrc/.

See Pierce, supra note 113 at 542.


Martin A. Sullivan, The Myth of Mom-and-Pop Businesses, supra note 5 (“despite all you may have been hearing -- there is nothing particularly wonderful about small business that it deserves special treatment from the federal government.”)

Jared Bernstein, Small Isn’t Always Beautiful, N.Y. TIMES (Oct. 24, 2011), at A23 (“The next time a politician tells you how he or she is for small business (which will likely be the next time you hear a politician say anything), be mindful that to the extent that size matters at all for job growth, it’s really about new companies that will start small and, if they survive, perhaps grow large. Everything else is largely noise — and too often, noise that has little to do with what this economy really needs.”)

Id. (“But politics has far more to do with emotion and perception than economic reality. Small companies are the darlings of the business world. have semi-sacred status in the American political economy…”).

Martin A. Sullivan, Start-Ups, Not Small Businesses, Are Key to Job Creation, supra note 97 (“[e]ven the Obama administration…will never attack the conventional
Small business, in a way, has developed into the beast that feeds itself.\textsuperscript{125} It has received a semi-sacred status in the American political economy.\textsuperscript{126} Over the years, small business owners have become “near and dear to the hearts of politicians in both parties.”\textsuperscript{127} Jared Bernstein, a senior fellow at the Center on Budget and Policy Priorities, and former chief economist and economic adviser to Vice President Joseph R. Biden Jr. nicely summed up the small business ethos in the political discourse noting, “I challenge you to find a stump speech by a politician running for any office from dog catcher to president that doesn’t invoke the importance of small businesses.”\textsuperscript{128}

Yet, this paper is about different things. In previous articles, I scrutinized the persistence of small business privileges using public choice theory and path dependence paradigm.\textsuperscript{129} I argued that current legal paths of small business preferences became dependent or locked-in an inefficient path due to a practice of “increasing returns” that occurred when supporting organizations lobbied and self-reinforced the spillovers created by small business entities.\textsuperscript{130} This atmosphere of vivacious “small business culture” that emphasized these entities’ positive contributions to economic development is one more explanation to why every politician, including Obama in his recent State of the Union speech, emphasizes the significance of small entities to the economy.\textsuperscript{131}

In conclusion, this part argued that there is no direct correlation between firm’s size and its entrepreneurial character. And some but not all small businesses promote free enterprise and job growth, not because wisdom about small businesses and job creation …because it does not want to offend the powerful small business community…Better to upset a few economists than lose the support of the public, which has been taught to equate tax increases for the wealthy with tax increases for small business job creators.”

\textsuperscript{125} Id. (“no politician of any persuasion wants to do anything but praise small businesses.”).

\textsuperscript{126} Martin A. Sullivan, The Myth of Mom-and-Pop Businesses, supra note 5 (“Small companies are the darlings of the business world. They have semi-sacred status in the American political economy, like family farmers and homeowners. They are doers. They are entrepreneurs. Public sentiment for small business is far more favorable than for large business. When it’s David versus Goliath, human nature inevitably draws us to root for the little guy. It almost goes without saying that any public relations effort by business will place as much emphasis as possible on the smallness of it.”)


\textsuperscript{128} Jared Bernstein, supra note 122.


\textsuperscript{130} Id.

\textsuperscript{131} See supra note 4.
of their size but due to their innovative character. Yet, even if one argues to the contrary, the next part will demonstrate that current definitions of size should be abolished because they are equally inconsistent and overinclusive. It will do so by examining various firm-size delineations found in different legal definitions of small entities and compare the corresponding firms that are captured by those definitions.

III. CURRENT DEFINITIONS OF SMALL

Now that we have identified the goals of the special regulatory treatment of small businesses, we turn to our present legal system. How do we distinguish small firms from other entities? There is no one uniform definition of size used to determine when an organization is considered a small business. In each area of law, size classifications vary. This part will review some of the most notable firm-size definitions and the corresponding population of firms they encompass. It will reveal that current size definitions are not only an inaccurate measure for promoting entrepreneurship, economic growth, and free enterprise, but are also inconsistent and overinclusive.

One entity may be considered a small business in securities law, but may not be treated as one when it comes to tax law or labor and employment law. In fact, only a small fraction of entities qualify as “small” across all definitions in all areas of the law. Many medium-sized firms are “free-riding,” taking the benefits intended for truly small entities. Therefore, the definitions do not fulfill the policy considerations they aimed to promote in the first place. Put differently, even if small businesses are responsible for the positive spillovers some people attribute to them, they are not properly classified in current legal size definitions.

1. Securities Law

Securities laws enable business entities to raise capital. These laws treat small entities differently by granting them more relaxed registration and reporting requirements. Small organizations under the Securities Act are defined according to their function in the market but are generally described as entities engaged in small business financing with total assets of $5 million or less. According to Regulation A of the Securities Act of 1933, small security offerings can be exempt from

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133 Small business financing can occur through the offering of securities, which enjoys regulatory concession. A small business offering is that which does not exceed a dollar limitation prescribed by the Securities Act of 1933 ($1 million or $5 million). See Securities Act of 1933 Regulations A & D, § 3(b) (1933).
Section 3(b) exempts from registration a public offer or sale of securities that meets certain requirements—for example, when the aggregate offering price does not exceed $5 million. Small security offerings require simpler financial statements and do not need to be audited; there are no Exchange Act reporting obligations after the offering unless the company has more than $10 million or less in total assets and more than 500 shareholders. While 98 percent of all corporations have assets of $10 million or less and can potentially qualify as small under this exemption, only 19.4 percent of all current public companies have total assets of $10 million or less and 500 shareholders or less.

Recently, the Securities and Exchange Commission amended its disclosure and reporting requirements to allow smaller reporting companies scaled disclosure requirements under regulation S-K. A “Smaller Reporting company” denotes companies with less than $75 million in public equity float. By expanding the concept of “smallness,” the regulations also expanded the number of companies that qualify for a scaled and simplified disclosure. Prior to the amendment, 28 percent of all reporting companies elected to take advantage of the small business issuer status. The Securities and Exchange Commission estimated that 41 percent will now be eligible as smaller reporting companies to utilize the new scaled disclosure requirements.

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135 15 U.S.C. § 78l(g) (2012) (Unlike Regulation A filings, Form SB-1 requires audited financial statements) See Q&A: Small Business and the SEC, http://www.sec.gov/info/smallbus/qasbsec.htm (Those reporting obligations are suspended if a company has fewer than 300 shareholders of the class of securities offered or if a company has fewer than 500 shareholders of the class of securities offered and less than $10 million in total assets for each of its last three fiscal years.).
136 In 2008, out of a total of 5,847,221 firms, 5,749,768 corporations had $10 million assets or less. Information on the number of shareholders of these firms was not found. See SOI Tax Stats – Corporation Source Book: Agriculture to Construction (sectors 11-23), Table I – All Returns with and without Net Income, INTERNAL REVENUE SERVICE (2008), http://www.irs.gov/taxstats/article/0,,id=165716,00.html.
137 Today, out of 15,000 active and inactive public companies, 10,284 have 500 shareholders or fewer, 4,613 have total assets of $10 million or less, and applying both conditions results in 2,915 public companies. See Mergent Online, Advanced Search Tool for U.S. Active and Inactive Corporations by Total Assets of $10,000,000 and 500 Shareholders or less. http://www.mergentonline.com/login.php.
139 The new Smaller Reporting Company Regulatory Relief and Simplification regulations replaced the definition of “small business issuer” with that of a “small reporting company.” The new regulation added the term “Smaller reporting companies.” See, 17 C.F.R. § 229.10(f) (2012).
140 Companies without a calcuable public equity float will qualify if their revenues were below $50 million in the previous year. 17 CFR §§ 210, 228, 229, 230, 239, 240, 249, 260, & 269.
141 Id. Prior to the amendment, 3,395 reporting companies elected to take advantage of the small business issuer status. The Securities and Exchange Commission has
Consequently, if almost half of all reporting companies appear eligible for the “small” exemption status, are all these firms really small?

2. Health Care

A key provision in the latest health care reform is the introduction of new benefits for small business employers. This portion of the reform sought to increase health insurance affordability for small business employers and therefore improve the access of employees to affordable health care. The reform added a new term, “small employer,” which is defined as an employer hiring up to 100 employees. Several other places in the Affordable Care Act apply this definition where the “small business employer” is mentioned. How many firms can utilize small business benefits under this reform? Many firms. According to the U.S. Census Bureau today about 66 percent of all employer firms have 100 employees or fewer.

The health reform law also introduced additional tax benefits that targeted small business employers. For example, a new refundable tax estimated that a total of 4,976 companies will be eligible to use the scaled disclosure requirements under the new amendments, out of a total of 11,898 reporting companies that filed annual reports in 2006. The Securities and Exchange Commission, Release Nos. 33-8876; 34-56994; 39-2451; File No. S7-15-07, at 9, available at http://www.sec.gov/rules/final/2007/33-8876.pdf.


144 See, Affordable Care Act, supra note 142 § 1304(b)(2) (Moreover, until 2016, states will be able to elect to limit that definition to 50 employees.)

145 For example, each state has to establish an American Health Benefit Exchange with Small Business Health Options Programs (SHOP). These Shops are designed to assist small business employers by enabling them to identify affordable health insurance coverage options. See, Affordable Care Act, supra note 142 § 1331(b). The health reform also provided for grants and technical assistance to assist states in establishing Small Business Health Options Exchanges. See LEXIS-NEXIS, TREATISE ON HEALTH CARE LAW §§ 11.1711.24. The Affordable Care Act established special “cafeteria plans” for small businesses and announced that the government will provide grants targeting small concerns to enable employees of such concerns to access workplace wellness programs. But for that purpose, the Affordable Care Act stated that employers with fewer than 100 employees who work 25 hours or more per week will be able to apply for those grants. See, Affordable Care Act, supra note 142 §§ 9022& 10408.

146 In 2008, out of 5,930,132 employer firms (firms with payroll), 3,617,764 firms had 1-4 employees (28.85%); 1,044,065 firms had 5-9 employees (17.6%), 633,141 firms had 10-19 employees (10.67%), 526,307 firms had 20-99 employees (8.8%), and 90,386 had 100-499 employees (1.5%). See, Statistics about Business Size (including Small Business), Table 2a, Employment Size of Employer and Nonemployer Firms U.S. CENSUS BUREAU (2008), http://www.census.gov/econ/smallbus.html [hereinafter Statistics About Business Size].
credit sought to cover up to 35 percent of the employer’s contribution (50 percent of the employer share by 2014). However, to benefit from the tax credit for some of the health care costs, a small business must have ten or fewer full-time employees. Firms with more employees are also eligible for a reduced tax credit, which phases out completely for employers with 50 employees or more. In corresponding numbers, about 60 percent of all employer firms have 50 employees or fewer and have the ability to take advantage of this tax subsidy. The term “small” here includes, in fact, a vast number of firms.

3. Labor and Employment

The Civil Rights Act and the Age Discrimination in Employment Act prohibit certain employment practices. Employers are not allowed to discriminate on the basis of race, color, religion, sex, or age in hiring, firing, compensating, or granting employment privileges. Nevertheless, both acts contain small business exclusions from liability. The Age Discrimination in Employment Act exempts employers with 20 employees or fewer, while the Civil Rights Act excludes employers with 15 employees or fewer. A similar exclusion can be found in the


148 Ten or fewer full-time employees with average annual wages of up to $25,000. See, Affordable Care Act, supra note 142 Patient Protection and Affordable Care Act, P§ 1421, 119, (amending I.R.C. § 45R(d)).

149 The amount of the credit is reduced by the sum of: “(1) Such amount multiplied by a fraction the numerator of which is the total number of full-time equivalent employees of the employer in excess of 10 and the denominator of which is 15. (2) Such amount multiplied by a fraction the numerator of which is the average annual wages of the employer in excess of the dollar amount in effect under subsection (d)(3)(B) and the denominator of which is such dollar amount.” See Affordable Care Act, supra note 142 § 1421(c).


152 Age Discrimination Act, supra note 151, § 623. The acts also provide that it is unlawful for employers to advertise for employment by indicating a preference for certain employees or to retaliate against employees or candidates who expressed their dislike of such unlawful behavior.

153 The term “employer” is delineated in this act as “a person engaged in an industry affecting commerce who has 20 or more employees for each working day in each of 20 or more calendar weeks in the current or preceding calendar year.” Prior to June 30, 1968, employers having fewer than 50 employees were not considered employers. Age Discrimination Act, supra note 151, § 62.

Americans with Disabilities Act, which provides equal opportunities for
disabilities. Here, too, the term “employer” is delineated
to include “a person engaged in an industry affecting commerce who has
15 or more employees for each working day….”\textsuperscript{155} Correspondently,
about 54 percent of small business owners and their employees are not
held liable for violations of those acts.\textsuperscript{156} Therefore, one is left to wonder,
what is the point of promulgating a rule from which more than half of the
existing entities are exempted?\textsuperscript{157}

Other labor and employment acts define small business differently.
The Occupational Safety and Health Act protects employees’ working
conditions.\textsuperscript{158} Therefore, the act encourages employers and their
employees to institute programs that provide a safer and healthier
environment.\textsuperscript{159} The threshold for an exemption from record keeping
under this act is 11 employees or fewer,\textsuperscript{160} which constitute a little more
than 46 percent of firms today.\textsuperscript{161} This is not a negligible part of all the
population of firms.

A parallel exclusion for small business appears in a related labor act:
the Family and Medical Leave Act, which excludes an employer with
fewer than 50 employees,\textsuperscript{162} and the Worker Adjustment and Retraining
Notification Act, which exempts firms with fewer than 100 employees
from notifying their employees in case of mass layoffs.\textsuperscript{163} In numbers,

\textsuperscript{155} 42 U.S.C. § 12111 (1990). A similar exclusion exists in the Consolidated
Omnibus Budget Reconciliation Act, which ensures individuals have continued access to
their health insurance in spite of certain events that otherwise would lead to termination
of coverage. This act exempts any group health plan of an employer employing fewer
than 20 employees during 50 percent of the preceding calendar year. 29 U.S.C.
§ 1161(b).

\textsuperscript{156} This is an estimate because there is was data available for 10-15 employees. In
2008, out of 5,930,132 employer firms (with payroll), 3,617,764 firms had 1-4 employees
(28.85%); 1,044,065 firms had 5-9 employees (17.6%), and 633,141 firms had 10-19
employees (10.67%). Statistics on Business Size, supra note 146.

\textsuperscript{157} See, e.g., Pacourek v. Inland Steel Co., 858 F. Supp. 1393, 1406 (N.D. Ill. 1994)
(criticized in Martinez v. Labelmaster, 1998 U.S. Dist. LEXIS 17733 (N.D. Ill. 1994) and
exclusion of small employers from liability under all three statutes, ‘in light of Congress’
intent to restrict the liability of small entities with limited resources, it is doubtful that
Congress intended to impose liability upon individual employees.”)


\textsuperscript{161} In 2008, out of 5,930,132 employer firms (with payroll), 3,617,764 firms had 1-4
employees (28.85%); 1,044,065 firms had 5-9 employees (17.6%), and 633,141 firms had 10-19
employees (10.67%). Statistics on Business Size, supra note 146.

is defined as an entity who employs fewer than 50 employees if the total number of
employees employed by that employer within 75 miles of that worksite is less than 50.

\textsuperscript{163} The Worker Adjustment and Retraining Notification Act, 29 U.S.C. § 2101(a)
(1988).
these acts exempt between 57 percent and 66 percent of all firms from complying with the rules set forth in these acts.\textsuperscript{164}

Lastly, in 1989, President Bush introduced a small business exclusion in the Fair Labor Standards Act.\textsuperscript{165} Accordingly, employees of businesses with annual sales of up to $500,000 are often unable to sue for unpaid overtime, minimum wage, or child labor if their employers do not meet the requirements.\textsuperscript{166} According to the Small Business Administration, 61 percent of all firms report receipts of $500,000 or less and therefore are exempted from the requirements of the Fair Labor Standards Act.\textsuperscript{167} Naturally, these exemptions receive much criticism on the grounds that they ignore the rights of millions of workers employed by small businesses and create a double standard.\textsuperscript{168}

\begin{footnotesize}
\textsuperscript{164} In 2008, out of 5,930,132 employer firms, 3,617,764 firms had 1-4 employees (28.85%); 1,044,065 firms had 5-9 employees (17.6%), 633,141 firms had 10-19 employees (10.67%), 526,307 firms had 20-99 employees (8.8%), and 90,386 had 100-499 employees (1.5%). Statistics on Business Size, supra note 146.

\textsuperscript{165} The term “Enterprise engaged in commerce or in the production of goods for commerce” was delineated in the act to include only an enterprise whose annual gross volume of sales made or business done is not less than $500,000 and was not engaged in interstate commerce. This amount is exclusive of excise taxes at the retail level that are separately stated. 29 U.S.C. § 203(s)(1)(A)(ii) (2012). For the legislative history of this act as it concerns small business, see Marc Linder, The Small-Business Exemption Under the Fair Labor Standards Act: The “Original” Accumulation of Capital and the Inversion of Industrial Policy, 6 J.L. & Pol’y 403, 444 (1998).


\textsuperscript{168} See, e.g., Ruben H. Arredondo, Different Strokes for Different Folks: Balancing the Treatment of Employers and Employees in Employment Discrimination Cases in Courts within the Tenth Circuit Court of Appeals, 16 BYU J. PUB. L. 261, 285 (2002) (criticizing small employer exemptions in anti-discrimination legislation); Harold S. Lewis, Jr. & Elizabeth J. Norman, Employment Discrimination Law and Practice 1.1 (2001); Kathleen M. Nichols Labor and Employment Law - Determining Employee Status for Evolving Business Associations Under the Americans with Disabilities Act - Clackamas Gastroenterology Associates, P.C. v. Wells, 538 U.S. 440 (2003), 38 SUFFOLK U. L. REV. 239 (2004) (“Congress determined these smaller entities would be unable to carry the burden of defending lawsuits when compared to their larger competitors. Several other federal anti-discrimination statutes also contain this exemption. As a result, the ADA does not cover over twenty million employees due to the size of the business.”).
\end{footnotesize}
4. Patent Law

One of the primary goals of patent law is to support research and
development. Its policy is also to incentivize investment in innovation
and invention by encouraging institutions to develop, collaborate and
secure patents. In the 1980s, the Bayh–Dole Act and its subsequent
amendments provided that certain research and development institutions
that patent inventions, such as universities, that patent inventions must
give licensing preference to small businesses. Regulations soon
followed to establish the right to innovations made through these
collaborations. The term “small business” was defined with reference
to the Small Business Act, as independently owned and operated and
which is not dominant in its field of operation and in accordance with the
size standards published by the SBA.

By the same token, U.S. patent laws provide small entities with
discharged rates for fees required for application, issuance, search, and
maintenance of patents. Small business concerns receive a 50 percent
reduction in most patent fees, and 75 percent if the patent was filed
electronically. To receive this benefit, the business owner must file a

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169 35 U.S.C. § 200

(It is the policy and objective of the Congress to use the patent system to
promote the utilization of inventions arising from federally supported research or
development; to encourage maximum participation of small business firms in
federally supported research and development efforts; to promote
collaboration between commercial concerns and nonprofit organizations,
including universities; to ensure that inventions made by nonprofit
organizations and small business firms are used in a manner to promote free
competition and enterprise without unduly encumbering future research and
discovery...).

Emily C. Lamb, Patent Reform and Its Effect on University Technology Transfer, FED.
LAW. 1, 12 (2008).

171 Rights to Inventions Made by Nonprofit Organizations and Small Business
Firms. 37 C.F.R. § 401. For example, The Department of Commerce is designated as the
federal agency to design licensing policy and to promote procedures implementing
legislation. See also, 35 U.S.C. §§ 200-212 (LexisNexis 2012). But see Deborah
businesses-2011-9 (criticizing the negative effect of the recent patent law reform on small
business).


1.445.

174 35 U.S.C. § 41(h)(3) was added by the Consolidated Appropriations Act of 2005,
Dec. 8, 2004, P. L. 108-447, § 1, 118 Stat. 2809, and provides that the filing fee charged
under 35 U.S.C. § 41(a)(1)(A) shall be reduced by 75 percent with respect to its
application to any small entity “if the application is filed by electronic means as
prescribed by the Director.” 35 U.S.C. § 41(h)(3). David L. Cameron & Thomas Kittle-
Intellectual Properties & Intangible Assets, 1998 WL 1038665, 37. The fees that are
written assertion of small entity status and explain why it qualifies for the status.\textsuperscript{175} Here, too, the small entity category is defined with reference to the Small Business Act.\textsuperscript{176} To be eligible for reduced patent fees, a small concern may not have more than 500 employees.\textsuperscript{177} At present, the SBA Office of Advocacy estimates that 99 percent of firms (including nonemployer firms that have no payroll) have fewer than 500 employees\textsuperscript{178} and over 67 percent of employer firms.\textsuperscript{179} Both figures demonstrate a preference granted to an overly broad segment of the market.

5. Government Contracting Law

The U.S. government has chosen a policy that promotes small businesses by allocating government contracts to them. Currently, 23 percent of government agency contracts must be assigned to small business entities.\textsuperscript{180} How does the government contracting law define a small business? The Federal Acquisitions Regulation (“FAR”)\textsuperscript{181} defines a small business as one that is independently owned and operated, is not dominant in its field, and meets applicable size standards.\textsuperscript{182} The SBA regulations determine the particular size standard in each industry.\textsuperscript{183}

Generally, the size standards are measured by the dollar volume of

\textsuperscript{175} 37 C.F.R. § 1.27(c).
\textsuperscript{176} Small Business Act, supra note 24, § 3.
\textsuperscript{177} 13 C.F.R. § 121.802.
\textsuperscript{179} In 2008, out of 5,930,132 employer firms, 3,617,764 firms had 1-4 employees (28.85%); 1,044,065 firms had 5-9 employees (17.6%), 633,141 firms had 10-19 employees (10.67%), 526. Statistics on Business Size, supra note 146.
\textsuperscript{180} Small Business Goaling, SMALL BUSINESS ADMINISTRATION, http://www.sba.gov/content/small-business-goaling.
\textsuperscript{183} 13 C.F.R. § 121.201 (2012). This is done according to the North American Industry Classification System (NAICS). This system, first introduced in 1997, replaced the Standard Industry Classification System (1987). See, SBA Size Standards Methodology, SMALL BUSINESS ADMINISTRATION, SIZE STANDARDS DIVISION, OFFICE OF GOVERNMENT CONTRACTING & BUSINESS DEVELOPMENT, 10 (April, 2009), http://www.sba.gov/sites/default/files/size_standards_methodology.pdf [hereunder “SBA Methodology”] (“for purposes of size standards, SBA utilizes the North American Industry Classification System (NAICS) of the United States as a basis for industry definition. Except for a few exceptions where a size standard may be established for an activity within in an industry, size standards are defined at the 6-digit NAICS level.”).
business or the number of employees. For businesses in wholesale, retail, service, and distributive trades, a small business is one with no more than $7 million in annual average receipts.\footnote{Summary of Size Standards by Industry, \begin{italics}SMALL BUSINESS ADMINISTRATION\end{italics}, http://www.sba.gov/content/summary-size-standards-industry.} For most manufacturing and mining industries, small businesses are those employing fewer than 500 workers;\footnote{In some industries such as manufacturing, small businesses are allowed to employ up to 1,500 people. In other industries, size is a function of the value of assets for financial institutions or mega-watt hours for electric service providers.} the standard for wholesale trade industries is 100 employees. As stated above, the SBA has reported that 99 percent of all firms are small businesses.\footnote{See, Statistics on Business Size, supra note 146.} Here, it seems that almost all firms are “small.”

The American economy has changed vastly since the SBA size baselines were first established in 1958.\footnote{The term “small business” was defined in the Small Business Act of 1958: For the purposes of this title, a small-business concern shall be deemed to be one which is independently owned and operated and which is not dominant in its field of operation. In addition to the foregoing criteria, the Administration, in making a detailed definition, may use these criteria, among others: number of employees and dollar volume of business. Small Business Act of 1953, 15 U.S.C. §§ 632(a) (1994).} The 500-employee size rule was in many ways just a continuation of a standard used in World War II by the Reconstruction Finance Corporation and the earlier Small War Plants Corporation.\footnote{For a review of these organizations and a historical account of the creation of the SBA, see Eyal-Cohen, \begin{italics}Why is Small Business the Chief Business of Congress?\end{italics}, supra note 2 (arguing that the small business investment company is an example of a process of positive feedback and increasing returns of small business preferences).} Yet, the SBA size standards have largely remained unchanged. The SBA idea of “small” has been entrenched in past notions of magnitude detached from the public’s current perception of such facet.

6. \textit{Internal Revenue Code}

The government offers potentially significant tax benefits to people who operate small firms or own stock in them. Small entities are mentioned in numerous places in the \begin{italics}Internal Revenue Code\end{italics} (“\begin{italics}Tax Code\end{italics}”). While one might expect the \begin{italics}Tax Code\end{italics} to have a consistent meaning for small businesses, in fact the definition changes from one section to another. This inconsistency adds to the complexity of the \begin{italics}Tax Code\end{italics} and the tax compliance costs endured by businesses.\footnote{General Explanation Of The Revenue Act Of 1978 at 194, (H.R. 13511, 95th Congress, Public Law 95-600) (holding that many small business firms do not reap the full benefits they are entitled to—either because they are not familiar with the myriad aspects of the code or because they do not get adequate advice on how to meet the various definitions of a “small business”).}
Section 1202 indirectly benefits small business investors. This section, which originated in 1993, allows noncorporate taxpayers to exclude from taxation any gains from the sale or exchange of qualified small business stocks. The Tax Code defines a qualified small business stock as that of a C corporation with less than $50 million in aggregate gross assets. The legislative intent behind this benefit was to encourage people to invest in small businesses and to foster their growth by offering incentives for high-tech, startup companies and stakeholders that invested in such companies.

A comparable tax benefit was later added in Section 1045 of the Tax Code. This section permits taxpayers to defer taxes indefinitely by allowing them to roll over capital gains on the sale of small business stock if the proceeds are reinvested in another qualifying small business stock. This rollover provision was intended to push down the effective tax rate on small business investment to zero if all proceeds are continuously reinvested in new small businesses. Qualified small business stocks were defined by reference to Section 1202 of the Tax Code. Currently, the Internal Revenue Service provides that 99 percent of all firms report $50 million of assets or less so potentially their

191 Individuals who own qualified small business stock for at least five years (§ 1202(a)(1)) can exclude up to 50 percent of the capital gain on disposition, limited to the greater of 1) $10 million reduced by any previously excluded gain attributable to such issuer, or 2) 10 times the aggregate adjusted basis of the qualified small business stock disposed of in the taxable year at issue. 26 U.S.C. § 1202(b)(1) (2012). See generally Overview of the Conference Agreement on the Revenue Provisions of the Omnibus Budget Reconciliation Act of 1993 (H.R. 2264), Prepared by the Staff of the Joint Comm. on Taxation, 103rd Cong. 3 (Aug. 23, 1993). Joshua E. Husbands, Comment, The Elusive Meaning of Small Business, 2 J. SMALL & EMERGING BUS. L. 355, 368 (1998).
192 The C corporation has to be actively engaged in trade or business with less than $50 million in aggregate total assets before and immediately following the issuance of the stock. 26 U.S.C. § 1202(c)(1), (d)(1)(B). Prior to the Tax Reform Act of 1986, the Tax Code provided a reduced tax rate on long-term capital gain rate by providing that “If for any taxable year a taxpayer other than a corporation has a net capital gain, 60 percent of the amount of the net capital gain shall be a deduction from gross income.” 26 U.S.C. § 1202 (1984). Although this tax benefit was highly debated between 1969 and 1976, in 1978 a heavily lobbied statutory change put that tax benefit into place until the Tax Reform of 1986. See William C. Whitford, Lowered Horizons: Implementation Research in a Post-CLS World, 1986 WIS. L. REV. 755, 764 (1986).
195 Victor Fleischer, The Rational Exuberance of Structuring Venture Capital Startups, 57 TAX L. REV. 137, 165 (2003) (arguing that the effect of qualified small business stock subsidies in sections 1202 and 1045 cause venture capitalists to favor the C corporation form of incorporation.) But see: John W. Lee, A Populist Political Perspective of the Business Tax Entities Universe: “Hey the Stars Might Lie But the Numbers Never Do”, 78 TEX. L. REV. 885 (2000) (arguing that section 1202 is unlikely to constitute a major factor in choice of tax entity due to the interplay of this preference with the Alternative Minimum Tax (AMT)).
investors are eligible for this exclusion.\textsuperscript{196} Considering public companies, 22.5 percent of all public companies potentially qualify for this favorable treatment.\textsuperscript{197}

Similar to this favorable treatment of gains, losses incurred on small business stocks also receive preferential treatment. Section 1244 of the Tax Code treats losses incurred by the sale of a small business corporation’s stock as ordinary losses and not as capital losses, resulting in a bigger write-off.\textsuperscript{198} Yet, here, a small entity is demarcated differently; it does not adhere to the definition in Section 1202. In Section 1244, a “small business corporation” is a corporation with an aggregate amount paid in surplus of $1 million or less at the time of issuance.\textsuperscript{199} Today, about 32 percent of all public companies are likely to receive this benefit.\textsuperscript{200}

A different example of a Tax Code provision that is intended to favor small businesses is Subchapter S of the Tax Code.\textsuperscript{201} This benefit allows certain corporations to enjoy a flow-through tax treatment by taxing only their shareholders on the corporate earnings. This preference, therefore, allows investors in a “small business corporation” (or “S corporation”) to avoid double taxation typically imposed on corporate earnings. To be able to qualify as an S corporation, a small business must be a domestic corporation with no more than 100 shareholders and with only one class of stock.\textsuperscript{202} The Internal Revenue Service reports that currently about 70 percent of all corporations elect to be taxed as S corporations, which

\textsuperscript{196} In 2008, out of a total of 5,847,221 returns with or without net income, there were 5,812,477 returns filed by firms with $50 million or less of assets. Statistics of Income, 2008 Corporation Source Book of Statistics of Income, U.S. Total, Returns With or Without Net Income, INTERNAL REVENUE SERVICE, http://www.irs.gov/taxstats/article/0,,id=165716,00.html.

\textsuperscript{197} Today, out of 15,000 active and inactive public companies, 7,365 companies have $50 million or less of total assets and 7,840 were incorporated/founded after 1993. Applying both conditions results in 3,403 public companies. See Mergent Online, Advanced Search Tool for U.S. Active and Inactive Corporations by Total Assets of $50,000,000 and Incorporation Date after 1993. http://www.mergentonline.com/login.php

\textsuperscript{198} 26 U.S.C. § 1244(a) (2012).

\textsuperscript{199} Id. at § 1244(c)(3). Other sections in the Tax Code refer to this definition of small business corporation. See, 26 U.S.C. § 1274.

\textsuperscript{200} Today, out of 15,000 active and inactive public companies, 4,768 companies have $1 million or less of stockholder equity. See Mergent Online, Advanced Search Tool for U.S. Active and Inactive Corporations by Stockholder Equity Less than $1 Million. http://www.mergentonline.com/login.php


remains a popular form of entity businesspeople choose for their organization.

Lastly, the research and development credit provides a credit equal to 20 percent of the qualified research expenses in excess of a base amount. Yet, the benefit provides a 100 percent tax credit for amounts paid for certain qualified research in an eligible small firm. An eligible small business here is defined as a business in which the taxpayer does not own a 50 percent or greater interest and in which there are 500 or fewer employees. As stated above, the SBA reported that over 99 percent of all firms employ 500 or fewer employees and therefore can qualify for that benefit.

To summarize this part, each area of the law and in each section within defines “small” differently. Those limits are often overinclusive. Accordingly, many larger and established firms that dominate their markets manage to meet some of the definitions of a small business. “Small” in the eyes of the law diverged from what is considered “small” in the eyes of the public. The following part will survey the criticism and disapproval of those size classifications in the public, media, and politics.

IV. DISAPPROVAL OF CURRENT SIZE CRITERIA

Even in 1953, when the Banking and Currency Committee first enacted the term in the Small Business Act of 1953, the committee recognized the “impossibility of attempting to write into law a rigid definition of small business.” The Committee acknowledged that it is

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203 In 2008, from a total 5,847,221 entities that filed C corporation returns, 4,049,944 filed S corporation returns. That year, the IRS received 31,607,710 total business returns, of which 3,146,006 were partnership tax returns (of which, 1,898,178 elected LLC status), and 22,614,483 were sole proprietorships. SOI Tax Stats - Integrated Business Data, Table 1: Selected financial data on businesses, Number of Returns, Total Receipts, Business Receipts, Net Income (less deficit), Net Income, and Deficit.


207 See supra text accompanying note 12.

208 See supra text accompanying note 16.

tricky to delineate entities strictly in terms of number of employees, amount of capitalization, or dollar volume of business.\(^{210}\)

Over the years, much criticism has been aimed at legal definitions of size, specifically the SBA’s size classifications. This part will survey three main contentions. First, the current focus on size defeats the purpose of promoting entrepreneurship, free enterprise, and job creation. Second, today’s size classifications are overinclusive and create undesirable distributional effects. Third, present firm size delineations subsidize medium and large firms, thus resulting in data distortion and wasteful government expenditures.

A. The Focus on Size Defeats Our Policy Considerations

While there is an overlap between entrepreneurial firms and small businesses, they are different entities.\(^{211}\) Entrepreneurs are individuals who create new combinations of resources in production.\(^{212}\) But clearly, not all small firms create that intended value.\(^{213}\) The focus on size is therefore flawed because it is not an accurate proxy for the qualities of the entrepreneurial firms.

In fact, entrepreneurial firms may be of any size.\(^{214}\) Studies observed that large firms have also been engaging in entrepreneurial-type behavior.\(^{215}\) Some business units within large and established corporations create breakthrough inventions that increase their entrepreneurial value.\(^{216}\) By emphasizing the importance of innovation, medium and large firms experiment with novel and emerging

\(^{210}\) SBA Methodology, supra note 183 at 3.


\(^{212}\) Schumpeter, supra note 53 at 51-52.

\(^{213}\) For example, scholars found that family business strategy focused on the needs of the family rather than the business and its purpose is to provide outlets for family investment and careers for family members. Lawrence R. Jauch & William F. Glueck, BUSINESS POLICY AND STRATEGIC MANAGEMENT 52 (1988).

\(^{214}\) Arnold C. Cooper, Carolyn Y. Woo & William C. Dunkelberg, Entrepreneurship and the Initial Size of Firms 4 J. BUS. VENTURING 317 (1989) (the study examines how smaller startup firms differ from large ones in the background of the entrepreneurs and their subsequent patterns of development).


\(^{216}\) Gautam Ahuja & Curba Morris Lampert, Entrepreneurship in the large Corporation: a Longitudinal Study of How Established Firms Create Breakthrough Inventions, 22 STRATEGIC MANAGEMENT J. 521, 521 (2001) (Using the chemicals industry the article argues that experimenting with novel emerging and pioneering technologies assist established firms to overcome certain traps and create breakthrough inventions).
technologies and become pioneers of revolutionary developments.\textsuperscript{217} Consequently, certain corporate managerial models were found to promote entrepreneurial initiatives in established and large firms through internal corporate venturing.\textsuperscript{218}

Additionally, a person who owns an enterprise does not necessarily contribute to the free enterprise system. Usually, small business owners are individuals who establish and manage businesses for the principal purpose of furthering personal goals.\textsuperscript{219} The business is these individuals’ primary source of income and consumes the majority of their time and resources. Often, these individuals perceive the business as an extension of their personality and an outlet to satisfy their family needs and desires.\textsuperscript{220} Business motives are often repressed when confronted with personal circumstances. Those livelihood businesses are not driven mainly by business reasons and therefore cannot be relied upon to maintain a free enterprise system.\textsuperscript{221}

A similar case can be made for the mistaken notion that small firms are the source of employment growth. The current debate in academic literature on whether small businesses indeed account for most of the job growth illustrates the flawed focus on magnitude.\textsuperscript{222} Labor statistics were found to be inconclusive as to the question of whether small businesses always create positive net job change.\textsuperscript{223} Current statistics on job growth revealed that within each category of size in the last twenty years, there has not been much change in net job gains and losses as a percentage of

\textsuperscript{217} Id.
\textsuperscript{218} See, e.g., Robert A Burgelman, Designs for Corporate Entrepreneurship in Established Firms, 26 CAL. MANAGEMENT REV. 154, 155 (1984) (the article presents a model of strategic behavior in established firms for identifying entrepreneurial activity and to improve its capacity to deal with entrepreneurial initiatives); Shaker A. Zahra, Donald O. Neubaum & Morten Huse, Entrepreneurship in Medium-Size Companies: Exploring the Effects of Ownership and Governance Systems, 26 J. OF MANAGEMENT 947, 947 (2000) (This study looked at data from 231 medium-size manufacturing companies and showed that commitment to entrepreneurship is high when executives own stock in their company; the board chair and the chief executive officer are different individuals; the board is medium in size; and, outside directors own stock in the company.).
\textsuperscript{221} Id.
\textsuperscript{222} See supra text accompanying notes 113, 122 and infra note 247-248.
\textsuperscript{223} Jared Bernstein, Small Isn’t Always Beautiful, supra note 122 (“But don’t small businesses at least fuel job growth? Sort of. It’s not small businesses that matter, but new businesses, which by definition create new jobs. Real job creation, though, doesn’t kick in until those small businesses survive and grow into larger operations.”);
employment.\textsuperscript{224} And new data has revealed that firm age, and not its size, is the main fuel for job creation.\textsuperscript{225}

Therefore, size does not seem to be directly correlated to growth in employment.\textsuperscript{226} As an alternative, if the government seeks to encourage employment, it could directly reward high growth businesses for each employee they hire.\textsuperscript{227} Nevertheless, the government chooses to indirectly encourage hiring by subsidizing certain businesses.\textsuperscript{228} By doing so, the government ignores the important qualitative features of employment, such as job stability and security, wage level, benefits, and satisfaction. Size simply cannot purport to capture these elements.\textsuperscript{229}

Lastly, assisting firms according to their size does not seem to promote “free enterprise” either. If free enterprise today means a system free of government intervention or concentrated economic power, small business regulations do not contribute to this aim.\textsuperscript{230} By regulating business size, the government interferes with market forces and benefits firms without regard as to their actual market value. Some of those

\textsuperscript{224} The size categories were 1-4 employees, 5-9 employees, 10-19 employees, 20-49 employees, 50-99 employees, 100-249 employees, 250-499 employees, 500-999 employees and 1000 or more employees. For example, firms with 5-9 employees were found to generate a minor net job increase between 1992 and 1999 but a negative change between 2007 and 2011. See Bureau of Labor Statistics, Table 3. Private Sector Firm-Level Gross Job Gains and Losses as a Percent of Employment, available at http://www.bls.gov/bdm/bdmfirmsize.htm#SIZE2.


\textsuperscript{226} Veronique de Rugy, Are Small Businesses the Engine of Growth? AEI working paper 123, Dec. 8, 2005, http://www.aei.org/files/2005/12/08/20051208_WP123.pdf ("The conventional claim about small businesses’ job creating rests mainly on statistical fallacies and misunderstanding of the data… the claim that small businesses are the fountainhead of job creation does not hold water.")

\textsuperscript{227} See generally David Smallbone, Roger Leig, and David North, The Characteristics and Strategies of High Growth SMEs, 1 INT. J. OF ENTREPRENEURIAL BEHAVIOUR & RESEARCH, 44 (1995).

\textsuperscript{228} President Obama emphasized the need to remove tax benefits for firms that do create employment. See, The White House Office of the Press Secretary, Remarks by the President in State of the Union Address (Washington D.C., Jan. 24, 2012) http://www.whitehouse.gov/the-press-office/2012/01/24/remarks-president-state-union-address ("So my message is simple. It is time to stop rewarding businesses that ship jobs overseas, and start rewarding companies that create jobs right here in America. Send me these tax reforms, and I will sign them right away.").

\textsuperscript{229} For example, small firms fail at a rate far higher than that of large firms, contributing to the unstable nature of employment. See Dun & Bradstreet, The State of Small Businesses Post Great Recession, An Analysis of Small Businesses between 2007 and 2011, available at http://www.dnbgov.com/pdf/DNB_SMB_Report_May2011.pdf (reporting that small business failure rates have increased by 40% from 2007 to 2010). See also Pierce, Small is not Beautiful, supra note 113 at 555.

\textsuperscript{230} Id.
businesses may not be effective anymore.\textsuperscript{231} Therefore, granting them regulatory preferences disrupts the natural cycle of the firm’s life. An alternative to this focus on size is a qualitative analysis of certain firms that benefit the market, such as maverick firms.\textsuperscript{232} In other words, the government may interfere in order to protect particular firms for which there is direct evidence of the positive spillovers they create to the free enterprise system.\textsuperscript{233}

In conclusion, policies designed to promote economic growth do not always have their intended effect. Several features of entrepreneurial and high growth firms are not correlated to the size of those firms. It seems that small firms may or may not be entrepreneurial or create jobs or promote free enterprise. Those that do promote these policy goals, do so not because of their inventive character and not their size. Since this is the case, the preferential treatment granted to small entities through the law, \textit{per se}, does not unequivocally achieve its goals.

\textbf{B. Current Emphasis on Size Generates Undesirable Distributional Effect}

Even if we accept the current demarcations of firms by size, they are, by far, too broad. There is something fundamentally flawed in a legal system that considers over 99 percent of all firms as “small” and provides regulatory preference to those firms.\textsuperscript{234} This wide definition of “small” status today means that the exception has become the rule.

Some commentators have long contended that many legal preferences designed to target small businesses are used mainly by large and established corporations.\textsuperscript{235} Politicians expressed their concerns that current small business definitions are too broad and do not fulfill their stated purpose. In recent hearings around the country on reshaping current size standards, businesspeople came together to express their dissatisfaction.\textsuperscript{236} One of the main urgings in the hearings was to change


\textsuperscript{232} See \textit{supra} note 38.


\textsuperscript{234} Frequently Asked Questions, \textit{supra} note 178.

\textsuperscript{235} See, \textit{e.g.}, Charles R. Babcock and Ellen McCarthy, \textit{Companies Weigh In on Definition of ‘Small’ Firm; Agency Considers Changing Size Limit}, WASH. POST, June 18, 2005, at D01 (expressing their discontent regarding the number of employees being the chief size anchor).

\textsuperscript{236} Statement of Andrew J. Biemiller, Director, Department of Legislation, American Federation of Labor and Congress of Industrial Organizations, The President’s 1978 Tax Reduction and Reform Proposals, Comm. on Ways and Means, Part 4 of 9 (Mar. 8 and 9, 1978) Part A, at 2238-2241 (“This package the President had an excellent
current size definitions to ensure that larger, more established firms do not unjustifiably utilize benefits designated for small businesses. Others suggested introducing a “micro” category for businesses to account for really small businesses.

The media often reported on inconsistencies of current regulatory preferences granted according to firm size. Various newspapers reported that firm size classifications became so liberal that they presently include medium and large firms. In a recent case, the media reported that the government listed a contract with one of the largest debris-removal firms in the country (a billion-dollar corporation that boasts of having a former vice president on its board of directors) as a small business contract during the cleanup after Hurricane Katrina. Although the company is not “a small business by any conventional standard,” the newspaper reports that “because of a loophole in federal regulations, a company can be counted as one if it was once small even if it is not now.” This report is just one among many, which have raised doubts about the validity of current legal size definitions and the demarcation of governments’ subsidies according to size.
Over the years, much criticism was directed specifically at the complexity and overinclusiveness of the SBA size definitions.\textsuperscript{243} As a usable set of size guidelines, the SBA size standards, some commentators argued, suffer from several deficiencies.\textsuperscript{244} They are lengthy and overdetailed and lack the simplicity that business owners and corporate executives require.\textsuperscript{245} Others complained that the SBA size standard based on headcount has allowed businesses with few employees but very high receipts to qualify as small.\textsuperscript{246}

Scholars have argued that relying on one benchmark of size to measure “smallness” is not enough to capture the complexities of all types of entrepreneurship.\textsuperscript{247} They protested against the arbitrariness and unfairness that result from using a single criterion in those definitions.\textsuperscript{248}

businesses” included global defense giants such as Lockheed Martin, General Dynamics, British Aerospace, Northrop Grumman and Science Applications International Corp. (SAIC) and their subsidiaries. Carol D. Leonnig, \textit{Agencies Counted Big Firms As Small; SBA Says It Will Correct Data on Federal Contracts}, \textit{Wash. Post}, Oct. 22, 2008, at A01 (“...the U.S. government is just lazy and lax in making sure to use legitimate small businesses that can do the work and keep down the cost to the taxpayers.”).

\textsuperscript{243} Fred P. Hochberg, \textit{Small Business Administration, Supporting America’s Engines of Growth}, in \textit{Mark Green & Michele Jolin, Change for America, Change for America, A Progressive Blueprint for the 44th President 7}, available at http://www.americanprogressaction.org/issues/2008/changeforamerica/pdf/sba.pdf (“current SBA methodology for size standard determinations is obsolete; it impairs the Agency’s ability to meet its charter and results in reckless waste of significant taxpayer funds without promoting the success of meaningful small business programs that stimulate the economy and mitigate inflation.”).

\textsuperscript{244} \textit{Id.} at 8 (“The problem is that current size standards are overly complex and out of step with a global economy. The complexity makes it difficult to determine whether a particular business qualifies as small...”).

\textsuperscript{245} \textit{Id.} at 8 (“...the U.S. government is just lazy and lax in making sure to use legitimate small businesses that can do the work and keep down the cost to the taxpayers.”).

\textsuperscript{246} Sari Horwitz, \textit{GSA Award Multiplies Math Box Profits}, \textit{Wash. Post}, Dec. 30, 1985, at F1 (“For instance, in 1985, the computer retailer MBI had $89.5 million in sales (and $2.6 million in net income), and was the most profitable of the top eight publicly held computer retailers. But it was still considered small according to the SBA size standards..... Armen A. Manoogian, president of MBI. “We meet all the Small Business Administration definitions of a small business even though we’re getting larger and larger. We have less than 500 employees.”).


\textsuperscript{248} Husbands, supra note 191, at 373 (“The $1 million cap on contributions to
It is problematic and controversial, they argued, to use one measure to
determine the eligibility of a firm to receive certain preferences.249

By its own admission, the SBA conceded that its current size
standards do not satisfy public’s notions of “smallness”:
Should SBA consider lowering its size standards? SBA
receives periodic comments from the public that its
standards are too high in certain areas or for some types of
Federal contracting opportunities….This has always been a
problem, one that SBA has had to deal with over the years.
SBA’s size standards appear large to the smallest of small
businesses while larger small business often request even
higher size standards. This problem is tied to Federal
procurement practice because contracts get larger year after
year, and they are often out of the reach of the “truly small
business.”250

This over inclusiveness of current size standards results in precluding
access from truly small entities to federal grants, loans, and contracts for
small entities.251 It is clear that “small,” according to today’s
classifications, is not “small” in the eyes of the public anymore.252 But
this is no surprise. The legislative process is not free from political
influence and lobbying efforts.253 Medium and large business lobbyists
advocate for the expansion of small business preferences, and with it the

249 See, e.g., National Federal Contractors Association, Implementation of a Multi-
http://www.nafcausa.com/solutions/Multidisciplinary%20NAICS.pdf (“we find that
the Agency is currently working against its own purpose, due to its insistence on using
antiquated size standards and methodologies that fail to support small businesses that are
not dominant in their field of operation.”).
250 SBA Methodology, supra note 183, at 47-48.
251 Charles R. Babcock and Ellen McCarthy, Companies Weigh In on Definition of
‘Small’ Firm; Agency Considers Changing Size Limit, WASH. POST, June 18, 2005, at
D01.
252 See, e.g., Margaret Webb Pressler, Business; Making the Most of a Conference
Call, WASH. POST, Sept. 27, 1999, at F10 (Dynamic Concepts still meets the
government’s definition of a small business, but it is not small, in the traditional sense.
To many, $25 million in revenue and 400 employees is big business. But in the exploding
arena of telecommunications… for most big contracts, the company is still too small to
be in the prime time.”).
253 For example, in 2005 Sen. Christopher S. Bond (R-Mo.) reintroduced legislation
that would repeal the restriction, imposed in 2003 after an SBA administrative judge
decided that venture-owned firms did not qualify as small businesses. Charles R.
Babcock & Ellen McCarthy, Companies Weigh In on Definition of ‘Small’ Firm; Agency
Considers Changing Size Limit, WASH. POST, June 18, 2005, at D01.
firm size criteria.\textsuperscript{254} With the support of organizations, such as the SBA and the Chamber of Commerce, there is a constant liberalization of the definition of “small business.”\textsuperscript{255} Therefore, more and more firms qualify for small business status each year.\textsuperscript{256} This continuous increase over the past years in the firm-size limit resulted in more firms utilizing small business preferences and government resources.\textsuperscript{257}

\textsuperscript{254} For example, the president of Peoples Gas Co., which supplied 75 percent of the gas consumed in the Chicago metropolitan area, advocated for expanding tax preferences that fostered capital formation. The President’s 1978 Tax Reduction and Reform Proposals, Comm. on Ways and Means, Part 4 of 9 (Mar. 8 and 9, 1978) at 2228.

\textsuperscript{255} One of the Chamber of Commerce’s argument in advocating the expansion of small business preferences is that not doing so would discriminate against many capital-intensive “small businesses” with more than $1 million of depreciable assets. The SBA reiterated such recommendations when reporting on the state of small business. Professionals also supported liberalization of small business stock rules. See Summary of Specific Recommendations Made by the SBA Task Forst on Venture and Equity Capital for Small Business U.S. Small Business Administration January 1977, The President’s 1978 Tax Reduction and Reform Proposals, Comm. on Ways and Means, Part 3 of 9 (Mar. 7, 1978) Part A, at 1401 (Recommending that the loss deduction limitations in section 1244 should be increased so that deduction of $50,000 instead of $25,000 and the limit on issuer equity capital and size should be increased respectively from $1,000,000 to $2,000,000 and from $500,000 to $1,000,000); see also Comments of Ernst & Ernst on the Proposed Revenue Act of 1978—H.R. 13511, Revenue Act of 1978, Comm. on Finance, Part 6 of 6 Parts (1978) Part A, at 1642 (“We support the House proposals to liberalize the rules relating to small business stock. They should assist in raising needed capital by decreasing the risks of such investments. We also believe that these changes provide some simplification and therefore should contribute to greater effective use of this section of the law by small businesses.”).

\textsuperscript{256} Essentially, the SBA uses government contracting information to support an increase to an industry’s size standard where the small business share that year is found to be low, but does not alter the standard if it finds that the share of small businesses is high. As a result, every year, as part of its ongoing comprehensive review of all size standards, the SBA continues to increase its size standards. SBA Methodology, supra note 183 at 19. For example, recently the SBA proposed an increase of its small business size standards for 35 industries and one sub-industry in North American Industry Classification System (NAICS) Sector 54, Professional, Scientific and Technical Services and one industry in NAICS Sector 81, Other Services. See Small Business Administration, Proposed Rules, Federal Register, Vol. 76, No. 51, Wednesday, Mar. 16, 2011, \url{http://www.regulations.gov/#/documentDetail;D=SBA-2011-0008-0001}.

\textsuperscript{257} For example, see Statement of Robert R. Statham of the Chamber of Commerce of the United States, the President’s 1978 Tax Reduction and Reform Proposals, Comm. on Ways and Means, Part 4 of 9 (Mar. 8 and 9, 1978) Part B, at 2392, 2418 (“the definition of a small business corporation under Section 1244 should be liberalized by increasing the equity capital limitation from $1 million to $2 million and increasing the permissible amount received by the corporation for its stock from $500,000 to $1 million”). See also Statement of George S. Koch, Chairman of the Federal Finance Committee, Council of State Chambers of Commerce, Appendix B. Communications Received by the Committee Expressing an interest in these Hearings, Revenue Act of 1978, Comm. on Finance, Part 6 of 6 Parts (1978) Part A, at 1347 (“…This limitation would discriminate against many small businesses which are capital intensive and have depreciable assets considerably above $1 million.”); see also S 3562, 95th Cong., 2d Sess. (Oct. 7 (legislative day, Sept. 28, 1978) (Proposing to increase the firm size from $1 million to $2 million).
Recently, present legal definitions of size cause also other distributional distortions in our society. The focus on size is not only wasteful, but also results in owners of medium and large firms benefiting more preferences meant for the little guy. In other words, high-income corporate shareholders are utilizing more preferences in an indirect way hiding behind the fig leaf of small business. For instance, Senator Dale Bumpers, D-Ark., who initially proposed a capital gains tax preference for new startup businesses, complained about the use of this preference by wealthy shareholders of large corporations: “I have never understood what economic benefit this country derives when somebody sells General Electric and uses the money and buys DuPont stock.”

C. Present Focus on Size Creates Data Distortion and Ineffective Allocation of Resources

Current size classifications add to the compliance and litigation costs of doing business. Many cases challenging small business size classifications have been adjudicated in the federal court system. Courts have been called upon to rule on what is “small,” especially in cases where small entities have become larger but are still listed as small on government contracting records. Size appeals have been litigated not only in the federal arena but also in state courts. In many cases, instead

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259 See, e.g., Diversified Maintenance Systems, Inc. v. United States, 93 Fed. Cl. 794, 801 (2010) (alleged misrepresentations regarding HUBZone set aside program eligibility); Pacific Helicopter Tours, Inc. v. United States, 2007 WL 5171114, 1 (Fed. Cl. 2007) (A post-award bid protest action); Stamford Wrecking Co. v. United Stone America, Inc., 912 A.2d 1044, 1049 (Conn. App. 2007) (Evidence that SBA treated contract as a “special trade” contract was not admissible to vary terms of subcontract agreement); Rotech Healthcare Inc. v. United States, 71 Fed. Cl. 393, 407 (Fed. Cl. 2006) (Non-manufacturer rule of the SBA applies to supply contracts which also require provision of some services.); United Enterprise & Associates v. United States, 70 Fed. Cl. 1, 7 (Fed. Cl. 2006) (Certificate of competency (COC) review by the SBA is required in a sole source 8(a) program procurement.).

260 See, e.g., Daniel B. Moskowitz, *Business Size is Ruled to be No Small Matter*, WASH. POST, Feb. 8, 1988 (the article describes a Pentagon set aside food service contract at West Point for small companies but the second place bidder cried foul, pointing to the fact that the lowest bidder was not really a small business. The Size Appeals Board agreed. Then the losing bidder did something unusual: It sued the low bidder under state law, claiming damages for fraud, misrepresentation and interference with its business. That opened the possibility of getting a large damage award. The trial court threw out the suit, saying that because the set-aside program is a federal matter, there is no room for state litigation. But on Dec. 30, the U.S. Court of Appeals in Denver reversed the trial court judge and put the case back on track. The judges explained in Integrity Management v. Tombs & Sons [836 F.2d 485 (10th Cir. 1987)] that as they saw it, the possibility of a liability suit would actually help achieve the objective of aiding small business by discouraging businesses that are too big from getting in the way of small firms that are supposed to win the contracts).
of simplifying life for business owners, current firm size definitions have increased their compliance and litigation costs.\textsuperscript{261}

That is not all, however. Studies on the contribution of small businesses to economic growth depend very much on how one defines a “small” business. And small business organizations such as the National Federation of Independent Business continuously emphasize that small business have generated 60% to 80% of net new jobs annually over the last decade and more than half of nonfarm private gross domestic product (GDP).\textsuperscript{262} The SBA reports each year in its economic report to the president that small firms account for more than half of the net new jobs created in the last decade.\textsuperscript{263}

Yet, these incomplete reports on the small business contribution to the economy are greatly affected by the way “small business” is defined.\textsuperscript{264} And the inclusion of medium firms in the legal definitions of “small” results in the overinclusion of these firms in those studies.\textsuperscript{265}

Consequently, these studies present a skewed picture that overrates the spillovers of “small” entities.\textsuperscript{266} Accordingly, these regulatory preferences and subsidies become further entrenched in our legal system.\textsuperscript{267} If we are consolidating various firms together under the term

\textsuperscript{261} Id.


\textsuperscript{263} Small Business Economy, supra note 3, at 1.

\textsuperscript{264} Jared Bernstein, Small Isn’t Always Beautiful, supra note 122 (“Besides, don’t most people work for small businesses, and aren’t such businesses the engine of job growth? Actually, no. In what may be the most misunderstood fact about the job market, although most companies are small — according to 2008 census data, 61 percent are small businesses with fewer than four workers — more than two-thirds of the American work force is employed by companies with more than 100 workers. You can tweak the definitions, but even if you define “small” as fewer than 500 people (as the federal government does, basically), you still find that half the work force is employed by large businesses.”).

\textsuperscript{265} Martin A. Sullivan, Start-Ups, Not Small Businesses, Are Key to Job Creation, supra note 97. (“[I]t is easy to say that any sector with net job creation was responsible for a large share of overall job creation…there are massive swings in gross job creation and gross job destruction by both large and small business…The arithmetic may be correct, but net employment growth figures leave a false impression.”)

\textsuperscript{266} This dilemma was expressed in the past when debating the limits of size definitions: “If we consider the firm with 100 to 500 employees as being in the intermediate class, then not more than 5,000 enterprises qualify as big business-less than 1/7 of 1 per cent of the business population. But those 5,000 companies employ nearly 40 per cent of the 40 million persons engaged in non-farm business. They wield an industrial influence far greater than that of the 23.4 million little firms with three or less employees, which crowd the bottom of the scale.” A.D.H. Kaplan, The Role of Small Business and Free Enterprise, 22 PROC. OF THE ACADEMY OF POLI. SCI. 17, 18 (1947) (“‘Small business’ is as elusive a term as ‘free enterprise’. Any line of demarcation drawn between small and big business will include some that are large enough to have big business characteristics, and it will exclude a number which, while physically large, have the problems.”).

\textsuperscript{267} On the path dependence of small business benefits see Mirit Eyal-Cohen, Why is
“small,” we have to show a substantial identity between the entities to be consolidated.

Nonetheless, across the various firm size definitions, there is a only diminutive group of firms included within all size delineations. These firms are the truly “small” firms. However, since only a minor group of small firms qualify as such in all legal size standards, the question that arises is: What about the rest of these firms, which qualify as “small” under one definition but not under another? The answer lies within the question. Since these firms are not truly “small” in the eyes of the legislature, they are by default medium firms. Thus, the present focus on size in legal definitions results in many designated small business benefits being utilized by unintended entities such as medium firms. Those medium firms that qualify as “small” reveal a wasteful allocation of government resources.

Consequently, the current focus on size in legal definitions lead to misallocation of government resources away from the more productive firms to small and medium firms that receive those funds solely by virtue of their size and not according to their contribution to the economy.268 This flawed emphasis on size, therefore, is “distortionary by allocating more resources to the small business sector than would otherwise be optimal.”269 At times of huge deficits and budget cuts this waste comes at the expense of the more useful government programs.270

V. CONCLUSION

The problems of today’s small business definitions are rooted in our history. In the early decades of the United States, the typical business enterprise was minor, local, and personal.271 The days of small-scale production, skilled artisans, and sole proprietorships envisioned small

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270 Martin A. Sullivan, Start-Ups, Not Small Businesses, Are Key to Job Creation, supra note 97 (“If government is kind to these likeable economic entities, is there really any harm? Well, yes. Economics is coldheated. Subsidies should not be the prizes of popularity contests. Without sound justification (such as correcting a market externality), government interference with resource allocation will hurt rather than help growth.”).

businesses such as the mom-and-pop shops and local traders. With the era of industrialization and mass production, the size of businesses grew larger, the structure of ownership became more diverse, management developed into a profession distinct from ownership, and clusters of corporations, rather than individuals, became a significant element of the American economy.

As the economy evolved in the past century, size was no longer the only characteristic of modern commerce and trade. Yet, this change has not been reflected in the eyes of the public, where “small” remained a catch phrase, the principal litmus test for everything that is good for the economy.

Small firms receive special regulatory relief for their importance to American free enterprise and a healthy economy. Federal statutes use a variety of criteria to define small businesses. The primary legal definition of small business is found in SBA size standards, which frequently delineate small entities according to their number of employees.

According to that definition over 99 percent of firms today

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273 And being recognized as a “small business” in the United States can bring considerable benefits. The federal and local governments provide direct and indirect subsidies to small businesses in the form of preferential tax treatment, secured loans, procurement contract set-asides, relaxed regulatory requirements, and more. For example, many states developed small business environmental assistance programs to assist a small business with environmental compliance. 2-9A ENVIRONMENTAL LAW PRACTICE GUIDE § 9A.03 (Lexis-Nexis). In employment and labor law, when calculating penalties to be assessed against employers, the Occupational Safety & Health Administration usually considers the size of the business. 8-188 Labor and Employment Law § 188.03 (Lexis-Nexis). Another example can be found in the Regulatory Flexibility Act (“RFA”) that requires that any agency conducting a notice and comment rulemaking to consider fully the rules’ effect on ‘small entities.’ In 1996, Congress further expanded these responsibilities by passing the Small Business Regulatory Enforcement Fairness Act. This Act gives the RFA sharper teeth by providing for judicial review of federal agencies’ RFA analysis. Joshua E. Husbands, Comment, The Elusive Meaning of Small Business, 2 J. SMALL & EMERGING BUS. L. 355, 368 (1998).


275 124 Cong. Rec. S17582-88 (daily ed. Oct. 7, 1978) (statement of Senator Orrin Hatch) (“Mr. President, the economic greatness of the United States has been built on the foundation of small business. The importance of small business to the economy of this country cannot be overstated. It is the backbone, the life blood, the linchpin of our system of free competitive enterprise. Individual small firms may be very small, but in aggregate they make up an inordinately important part of our economy.”).

276 Current SBA size standards define small business as either having 500 employees or fewer or $7 million of receipts or less. There are certain exceptions to this rule: most
Consequently, one has to wonder, are all firms small? Current legal delineations of size have three main drawbacks: They are inconsistent, overinclusive, and have strayed far from their legislative intent. Small businesses are defined differently across areas of the law. These definitions are no longer restricted by past perceptions of minor entities and often include medium firms that exploit government resources intended for truly small entities. This overinclusiveness results in a discrepancy between current legal definitions and the public perception of what is “small.” One normative conclusion could be to acknowledge our impulse to help “truly” small businesses for political, historical, or other normative appeal. Another solution may be to completely abandon our focus on size.

This paper maintains that size is not an absolute feature of companies having positive economic impact. The rapid change from pioneer days to modern economy requires a new set of legal definitions. Firms of different sizes are engaged in distinct, particular entrepreneurial activities and subsequent patterns of economic development. This diversity should be recognized in our legal definitions and in various assistance programs. With the advancement of the modern society we also witnessed a development in our policy goals. Today, free enterprise and entrepreneurship can transpire in various ways in all sizes of businesses; reducing unemployment is a policy concern that can be achieved by all types of businesses. To continue to measure those goals only by size is to defeat their purpose.

Recently, President Obama asked Congress to grant him the power to consolidate the SBA with the U.S. Trade and Development Agency,

prevailed levels of size standards for mining and manufacturing industries are 500 employees, 750 employees, and 1,000 employees. Only three manufacturing industries have a 1,500-employee size standard. The wholesale trade sector has a single size standard of 100 employees. SBA Methodology, supra note 183 at 23.


Overseas Private Investment Corporation, Export-Import Bank, Office of the U.S. Trade Representative and some U.S. Department of Commerce programs into one super pro-business agency.\textsuperscript{281} The purpose of this proposal was to maintain “one department where entrepreneurs can go from the day they come up with an idea and need a patent, to the day they start building a product and need financing for a warehouse, to the day they’re ready to export and need help breaking into new markets overseas.”\textsuperscript{282} Obama added, “these changes would help small-business owners like you. It would also help medium and large businesses.” This integration is the first sign of the administration’s shift from size-centered to goal-driven approach.\textsuperscript{283}

This paper lays a foundation for future scholarly research on new and emerging entities. There are extensive studies on the ineffectiveness of antitrust legislation and price discrimination acts that currently constitute “the stick” by which the government attempts to regulate the market. It is time to examine the usefulness of legislation that represents the “carrot” end of the equation. Put differently, how effective are current legal preferences in delivering their promise to improve our economy?

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\textsuperscript{282} Id.

\textsuperscript{283} Although, some commentators have already expressed their concern that small will lose its status in the political agenda. Rhonda Abrams, \textit{Small Business Strategies: Obama's proposal could hurt}, USA TODAY, Jan. 19, 2012 (“I'm also somewhat concerned about the president's use of the term 'entrepreneur'… If the president's plan goes through as proposed, small businesses will lose their seat at the table… Being part of a larger agency is almost certain to diminish what little voice it has now… while it may be a great idea to bring all the animals under one roof, when you do, the smallest ones are most likely to get trampled.”) \textit{See also}, Jose Pagliery, \textit{Some Businesses Worry About Obama's SBA Move}, CNN Money, Jan. 13, 2012, http://money.cnn.com/2012/01/13/smallbusiness/obama_agencies/ (“'Throwing a small business in the same pot with General Electric (GE, Fortune 500) or Microsoft (MSFT, Fortune 500) or eBay doesn't work very well,' said Dan Danner, president of the National Federation of Independent Business…. However, consolidating operations into one worries Lloyd Chapman, president of the American Small Business League. He said the existence of a larger department will eliminate transparency and ease the ability to cut staff that ensures small businesses receive the legally-mandated 23 percent of all federal contracts.”)