



The Economic Impact of Sequestration on Small Business

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Small Businesses: The Backbone of Our Economy

Small businesses in America are anything but small when one considers their overall economic impact. Defined by the Small Business Administration as an “independent business having fewer than 500 employees,” small firms in our country employed half of all private sector employees, generated 65 percent of net new jobs over the past 17 years, hired 43 percent of high-tech workers and were responsible for roughly one-third of export value.¹

The U.S. government has long recognized the role of small business in our economy and sought to promote and protect this sector. “From the mom-and-pop storefronts that anchor Main Street to the high-tech startups that keep America on the cutting edge, small businesses are the backbone of our economy,” states Secretary of Transportation Ray LaHood. “These businesses create two out of every three jobs in America, helping spur economic development in communities across our country and giving millions of families and individuals the opportunity to achieve the American dream.”²

House Small Business Committee Chairman Sam Graves (R-Mo.) recently noted, “The vital role small business plays in economic growth is still overlooked. Together, these small firms consistently create 60 to 70 percent of new jobs, year after year, and employ more than half of the entire U.S. workforce at 27 million different places of business. That means we all have a vested interest in keeping that dynamic job creation going strong.”³ Rep. Nydia Velázquez (D-N.Y.), the ranking Democrat on the House Small Business Committee states, “Our nation has always relied on the proven innovation and flexibility that comes with a small business economy.”⁴

Small Businesses are Major DOD, NASA Suppliers

Our nation’s aerospace and defense programs are particularly dependent on small business inputs. These businesses are frequently sole suppliers of critical components that go into major weapons, aircraft, spacecraft and satellite systems. Federal policy is specifically geared toward fostering small business as an important part of the supply chain, and in 2011, 20 percent of Department of Defense prime contracts and 35 percent of DOD subcontracts (measured in

¹ U.S. Small Business Administration: Frequently Asked Questions. Advocacy Small Business Statistics and Research. September 2012. Retrieved from <http://web.sba.gov/faqs/facIndexAll.cfm?areaid=24>

² LaHood, Ray. “Small Business Saturday Celebrates the Backbone of America.” November 26, 2011. Retrieved from <http://fastlane.dot.gov/2011/11/small-business-saturday-a-day-to-celebrate-the-backbone-of-america.html>

³ Graves, Sam. “The Hill’s Congress Blog: Jobs Report Falls Short, Yet Again.” September 7, 2012. Retrieved from

<http://thehill.com/blogs/congress-blog/economy-a-budget/248189-jobs-report-falls-short-yet-again>

⁴ Velázquez, Nydia. Congresswoman Nydia M. Velazquez: Small Business. Retrieved from <http://velazquez.house.gov/issues/small-business.shtml>

dollars) were awarded to small businesses.⁵ Similarly, in 2011, 18 percent of NASA prime contracts went to small businesses and 38 percent of its subcontracts to small firms.⁶ Additionally, between two-thirds and three-quarters of defense industrial purchases are directed to small suppliers.⁷

Given the fact that America's aerospace and defense industry owes its origin to small business pioneers such as Orville and Wilbur Wright and Glen Curtiss, it is no surprise that small businesses continue to play an essential role in the development and delivery of high-tech solutions. In *Aviation Week & Space Technology's* September 3/10, 2012 cover story about small business innovation, National Academy of Sciences technology and innovation expert Charles Wessner observed, "Small companies are an incredibly rich source of innovation. That is where big technology companies come from, and that is where the big companies go to for innovative ideas." Wessner added small companies that focus on component and subsystem development "generally are more agile and able to adapt to changes in market conditions much more quickly than large corporations. And they are committed to driving ideas forward. That is key."⁸

Battling Severe Economic Head Winds

As much as our nation has come to rely upon small businesses to be a reliable producer of innovative, quality aerospace and defense components and products, many of these companies are battling severe economic head winds that larger companies are better able to navigate. The financial performance of aerospace and defense companies are closely related to their ability to obtain capital at favorable rates. Even though interest rates are at historic lows, traditional sources of capital remain scarce for small- to medium-sized aerospace and defense manufacturers. This could make it more difficult for them to meet demand as orders increase and the economy recovers. Indeed, during the past five years, the total value of small commercial and industrial business loans under \$1 million declined.⁹ A survey conducted by the National Small Business Association in 2012 found that 43 percent of small business respondents claimed that over the prior four years, they needed extra funding, but were unable to find loans.

Sequestration Small Business Job Impacts

In addition to concerns about how small businesses are being affected by trends in the larger economy, given small businesses' role in providing key services and products to DOD, the FAA, NASA, NOAA and the rest of the Federal government, it should come as no surprise that \$1 trillion in sequestration budget cuts to DOD and non-DOD programs over nine years, as mandated by the Budget Control Act of 2011, will dramatically impact smaller firms. George

⁵ DOD FY 2011 Small Business Procurement Scorecard. Retrieved from http://www.sba.gov/sites/default/files/files/FY11%20Final%20Scorecard%20DOD_2012-06-29.pdf

⁶ NASA FY 2011 Small Business Procurement Scorecard. Retrieved from http://www.sba.gov/sites/default/files/files/FY11%20Final%20Scorecard%20NASA_2012-06-29.pdf

⁷ DOD Annual Industrial Capabilities Report to Congress September 2011. Retrieved from http://www.acq.osd.mil/mibp/docs/annual_ind_cap_rpt_to_congress-2011.pdf

⁸ Velocci, Anthony L. , "Technology's Vanguard: Small companies' capacity to innovate will continue to drive progress in many areas." *Aviation Week & Space Technology*, September 3/10, 2012, pp. 56-67.

⁹ Federal Deposit Insurance Corporation (July 2012): "Small Business and Farm Loans." Retrieved from www2.fdic.gov/QBP/timeseries/SmallBusiness&FarmLoans.xls.

Mason University economist Dr. Stephen Fuller estimates that in 2013 alone, sequestration will put at risk 2.14 million jobs, including 956,181 small business jobs from supplier companies and mom-and-pop stores. As contracts are cancelled, re-negotiated, or otherwise reduced, small business leaders will have limited flexibility in adjusting their business model. While some will seek to diversify, others will just downsize, and still more may simply have to close their doors.

These potential impacts are a big source of concern among the leaders of major aerospace and defense contractors. “[Sequestration] will cause dramatic program and personnel dislocations within our industry, with our government customers, and will disrupt the lives of a significant portion of our 120,000 employees and their families,” Lockheed Martin Chairman and CEO Robert Stevens wrote to a group of U.S. Senators. “[We] do not know how many of our 40,000 supplier contracts may have to be broken...In fact, we are very concerned that the most vulnerable segment of our supplier base is the over 12,000 small and minority businesses...”¹⁰ In a similar letter, Raytheon Company Chairman and CEO William H. Swanson wrote, “All of our suppliers could be affected by sequestration, but the impact on our small business suppliers could be particularly pronounced... These small businesses are particularly susceptible during times of economic uncertainty or distress.”¹¹

With sequestration set to begin on January 2, 2013, defense and non-defense discretionary federal programs are bracing for cuts of \$100 billion in the remainder of Fiscal Year 2013. Congress can act prior to January to repeal sequestration, but as of now, sequestration is the law of the land and aerospace and defense companies are girding for what many commentators have described as a purposeful fall off a “fiscal cliff,” one that will wreak havoc both on the economy and national defense.

The Faces of Sequestration: Real People. Real Impacts.

While the numbers behind potential small business impacts of sequestration are stark enough, it is also useful to put a human face on the problem.

Cheryl Snead, the President and CEO of Banneker Industries, a 20-year-old supply chain management solution provider in North Smithfield, R.I., emphasizes the role of small businesses like hers in creating and sustaining jobs. “The aerospace and defense industry through this economic time has been the one to maintain jobs and to create jobs,” she says. “Our business has grown. And to now have to start to deplete that I think will have a detrimental effect. Every one of our team members adds value and to have to lose any of them I think will have a tremendous impact not only on our company but our ability to service our customer, which includes the government and the war fighter.”

¹⁰ U.S. Senator John McCain Press Release. “Defense Industry Leaders Express Concern About Impacts of Defense Sequestration on their Employees, Companies, and America’s Security. September 10, 2012. Retrieved from http://www.mccain.senate.gov/public/index.cfm?FuseAction=PressOffice.PressReleases&ContentRecord_id=b0cbb5db-b432-b7f8-2b3e-217d42f7697c.

¹¹ Ibid.

Bob White, a Vice President and Divisional Manager for Manufacturing Services of the IT consulting and solutions company Milletech in Northampton, Mass., observes that cutting back on government technology investments will harm the larger economy. “We work in a pretty high technology area,” he says. “Those tend to be the areas that are pushing the technology envelope. You get good command of a technology niche. You work that niche. The government benefits from that niche. They need these technologies for the systems to work. And you can also commercialize that technology and it has an impact on the broader economy. So our concern is when you take away those dollars and you don’t have that investment going on, you’ve got to restructure and readjust if your revenue goes away. There’s only so much internal research and development we can fund as an organization of our size. We’re concerned going forward with the impact of sequestration on high tech defense suppliers, small businesses like us.”

James Tabbi, the President and CEO of RAF Tabtronics, a Piffard, N.Y., business that designs and manufactures advanced electromagnetic technologies, is already feeling the impact of sequestration. “We’ve seen our customers already start pulling back and just be hesitant to cut purchase orders,” he states. “We’ve already seen jobs shrink in our company. Whenever you lose talented people, you lose capability that you may not be able to get back in a month, or two months or a few years down the road. There’s always the risk of that especially in a small company. Any cutbacks we have to make are very serious.”

In July, the leaders of seven small- and mid-sized Ohio businesses wrote to their members of Congress stating, “the harm from sequestration cuts will flow quickly down to small- and mid-sized businesses like ours. Sequestration could sound the death knell for many smaller businesses without the deep pockets and global business portfolio needed to weather such a storm.” They added, “The consequences for America’s security would also be dire. In many cases, smaller firms are the only repository of critical design, engineering or manufacturing expertise – unique skills like military-grade precision tooling and advanced composites manufacturing that are essential to American military, aviation and space leadership. If we squander American capabilities in such areas – often built up through decades of investment and on-the-job experience – we will pay the price for generations.”¹²

Not all the small businesses affected by sequestration are aerospace and defense suppliers. In Taunton, Mass., Deanna Smith, owner of a small tobacco and cigar shop, worries that a nearby General Dynamics plant will be hit hard by defense cuts, thus hurting her business. She told the Boston Globe that if the company lays off people, she and other store owners in Taunton will surely feel the loss. “It hurts everyone, because now those guys won’t stop into a local sub shop to get something small (to eat) on the way home, or they won’t come by here,” Smith said. “It adds up.”¹³

¹² Letter to Ohio Senators and Representatives, July 18, 2012. Retrieved from <http://www.oai.org/docs/OhioSupplyChainLetter-July2012.pdf>

¹³ Adams, Dan, “In Taunton, A Feeling of Angst Over Defense Cuts.” July 4, 2012. Retrieved from http://articles.boston.com/2012-07-04/business/32524291_1_communications-project-contract-general-dynamics

Small Business Sequestration Impacts Across Federal Agencies, States

According to Dr. Fuller's analysis of small business impacts, approximately 45 percent of all job losses in the first year of sequestration would come from businesses with 500 or fewer employees. The range of job losses will vary by state and by DOD (47.7 percent) and non-DOD cuts (41.6 percent). The difference between DOD and non-DOD job losses results from the fact that the DOD reductions will have a much smaller impact on federal jobs (14.8 percent of the direct jobs losses are from DOD cutbacks). Conversely, the non-DOD cutbacks will have a large initial impact on federal workers with the loss of 229,116 federal jobs directly accounting for 54.4 percent of the non-DOD direct job losses. Of the private sector job losses, 50.2 percent of those resulting from the DOD cuts will be in small business while 53.4 percent of those from the non-DOD cuts will be in small business.

Because of the differences in job types impacted by the federal budget in the various states, the impact of sequestration on small business in these states will also differ. The following table outlines the projected employment impact by state.

The Economic Impact of the Budget Control Act of 2011 on Small Business



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State Employment Impacts on Small Businesses of the Budget Control Act of 2011 in Fiscal Years 2012 and 2013

State	Small Business Job Losses, DOD Cuts	Small Business Job Losses, Non-DOD Cuts	Total Small Business Job Losses
Alabama	12,812	4,965	17,777
Alaska	2,813	1,880	4,693
Arizona	16,823	5,801	22,624
Arkansas	1,719	2,308	4,027
California	64,532	37,553	102,085
Colorado	8,802	10,036	18,838
Connecticut	17,292	2,377	19,669
Delaware	31	889	920
District of Columbia	7,240	46,700	53,940
Florida	20,000	15,626	35,626
Georgia	13,177	11,194	24,371
Hawaii	3,750	1,178	4,928

State Employment Impacts on Small Businesses
of the Budget Control Act of 2011 in Fiscal Years 2012 and 2013
(Continued)

	Small Business Job Losses, DOD Cuts	Small Business Job Losses, Non-DOD Cuts	Total Small Business Job Losses
Idaho	469	3,923	4,392
Illinois	11,094	12,653	23,747
Indiana	7,135	3,741	10,876
Iowa	2,500	2,446	4,946
Kansas	2,969	3,193	6,162
Kentucky	8,125	4,835	12,960
Louisiana	9,010	3,975	12,985
Maine	2,031	1,253	3,284
Maryland	18,802	31,373	50,175
Massachusetts	19,792	7,917	27,709
Michigan	6,458	7,356	13,814
Minnesota	2,344	4,628	6,972
Mississippi	2,500	2,677	5,177
Missouri	16,042	7,273	23,315
Montana	468	1,691	2,159
Nebraska	1,249	1,668	2,917
Nevada	2,031	2,561	4,592
New Hampshire	1,719	1,126	2,845
New Jersey	12,136	7,388	19,524
New Mexico	2,344	9,787	12,131
New York	13,750	17,143	30,893
North Carolina	5,677	7,254	12,931

State Employment Impacts on Small Businesses
of the Budget Control Act of 2011 in Fiscal Years 2012 and 2013
(Continued)

	Small Business Job Losses, DOD Cuts	Small Business Job Losses, Non-DOD Cuts	Total Small Business Job Losses
North Dakota	469	1,032	1,501
Ohio	10,156	7,957	18,113
Oklahoma	3,802	3,267	7,069
Oregon	1,406	3,755	5,161
Pennsylvania	19,063	16,025	35,088
Rhode Island	1,250	778	2,028
South Carolina	7,031	6,500	13,531
South Dakota	938	1,139	2,077
Tennessee	4,843	12,055	16,898
Texas	47,240	25,170	72,410
Utah	3,958	3,220	7,178
Vermont	1,094	736	1,830
Virginia	65,000	29,700	94,700
Washington	8,125	10,261	18,386
West Virginia	469	3,772	4,241
Wisconsin	13,177	3,722	16,899
Wyoming	312	884	1,196
Guam	1,041	204	1,245
Puerto Rico	1,041	1,272	2,313
Undistributed	12,348	17,965	30,313
Totals	520,399	435,782	956,181