The Impact of Federal Regulations

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THE PENNSYLVANIA TECHNICAL ASSISTANCE PROGRAM (PENNTAP), A PUBLIC SERVICE OF THE PENNSYLVANIA STATE UNIVERSITY AND THE COMMONWEALTH OF PENNSYLVANIA, UNDER A CONTRACT FROM THE U.S. SMALL BUSINESS ADMINISTRATION'S OFFICE OF ADVOCACY, HAS MANAGED THIS ECONOMIC PROJECT TO ANALYZE THE PAST AND CURRENT STATUS OF AND TO MAKE RECOMMENDATIONS FOR THE FUTURE WELFARE OF SMALL BUSINESSES IN REGION III.
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"Impact of Government Regulation on Small Business in Region III"

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# CONTENTS

<table>
<thead>
<tr>
<th>CONTENTS</th>
<th>PAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABSTRACT</td>
<td>D4</td>
</tr>
<tr>
<td>SECTION I - PROBLEMS</td>
<td>D5</td>
</tr>
<tr>
<td>SECTION II - IMPACT</td>
<td>D9</td>
</tr>
<tr>
<td>Survey Statistics</td>
<td>D10</td>
</tr>
<tr>
<td>Communications</td>
<td>D10</td>
</tr>
<tr>
<td>Costs</td>
<td>D13</td>
</tr>
<tr>
<td>Growth Opportunities</td>
<td>D13</td>
</tr>
<tr>
<td>Psychological Costs</td>
<td>D14</td>
</tr>
<tr>
<td>Regulatory Burdens</td>
<td>D15</td>
</tr>
<tr>
<td>SECTION III - CONCLUSIONS AND RECOMMENDATIONS</td>
<td>D17</td>
</tr>
<tr>
<td>Communication</td>
<td>D18</td>
</tr>
<tr>
<td>Compliance</td>
<td>D18</td>
</tr>
<tr>
<td>Enforcement</td>
<td>D19</td>
</tr>
<tr>
<td>Efficacy</td>
<td>D19</td>
</tr>
<tr>
<td>Common Sense</td>
<td>D19</td>
</tr>
<tr>
<td>BIBLIOGRAPHY</td>
<td>D21</td>
</tr>
</tbody>
</table>
IMPACT OF REGULATIONS

ABSTRACT

There is no argument over the need for government regulations. But...

Take one step off that rather innocent line of consensus, in any direction, into the real world of small business and you find the kind of ill-will and disenchantment that would make playing with hornet's nests a child's game by comparison.

To describe the private sector regard for the way government handles regulations, on a scale of 0 to +100, you don't have to worry about running out of plus signs. The ratings are consistently negative.

The results of a survey conducted for this study provided additional verification of the prevailing attitudes toward regulations. They are:

-- Inadequate communication between the federal government and small business causes unnecessary burdens on managerial and financial resources;

-- Costs of compliance are overwhelming, delaying product introduction, imposing psychological loads, causing confusion and adversary relationship;

-- Regulatory requirements instill fears of additional unnecessary government intervention in operations and planning;

-- Government representatives are often arrogant and seldom know or consider the realities confronting small businesses;

-- Businessmen feel the burdens of regulation place them at a competitive disadvantage with larger business counterparts;

-- Complexity and costs of compliance cause firms to reject programs designed originally to create benefits; hence, regulations in certain cases hurt rather than help the economy;

-- Unreasonable time delays in the regulatory process have a severe impact on small business;

-- IRS and OSHA account for 40 percent of regulatory complaints in this survey;

-- Clear, understandable, common sense language apparently is not within the grasp of government regulation writers or interpreters.
REGION III
CHAPTER D

SECTION I: REGULATION PROBLEMS

Three general conclusions can be drawn from this study.

Communications

The communications network between the federal government and small business is inadequate. This inadequacy results in unnecessary burdens on managerial and financial resources since the owner/manager or top management of a small corporation must spend valuable time and money hiring outside services for regulatory interpretation and counsel.

Costs

In addition to the dollar expense of hiring outside information, additional costs are associated with government regulation. Regulatory compliance causes delays in new product introduction and innovation as well as imposes psychological costs on the small businessman. These psychological costs result in frustration, confusion and adversary relationships with the governmental agencies. These affect the overall performance of the small business.

Federal regulations have resulted in the rejection of potential financial alternatives due to high fixed costs of entry caused by regulatory requirements (i.e., pollution controls) and fear of future government intervention in the industry under consideration.

Regulatory Burdens

Businessmen felt that the present structure of federal regulation did not adequately consider the realities confronting the small businessman. As a result, businessmen felt that they are placed at a competitive disadvantage with their larger corporate counterparts.

Findings indicated that the complexity and costs of compliance have caused them to reject programs which were intended to benefit employees of their firms. Hence, regulatory requirements in certain instances hurt those individuals which they were designed to protect.
IMPORTANCE OF SMALL BUSINESS

The term small business by itself does not offer appropriate insights into that entity which it describes. Therefore, it is important with any study of small business to define this term. For the purpose of this study we have arbitrarily chosen to accept the designations put forth by the Small Business Administration (SBA). While the SBA's definition of small business varies among industries and is constantly being revised, the number of employees and dollar sales volume are consistently used to differentiate small firms from large. (Generally, the standard agreed upon for this national study of regional small business environment was to classify firms employing less than 500 as small businesses.) At this time, other SBA standards by business type include:

- **Manufacturing** -- number of employees may range up to 1,500, depending upon the particular industry.
- **Wholesaling** -- yearly sales do not exceed $9.5 million to $22 million, depending upon the industry.
- **Services** -- annual receipts do not exceed $2 million to $8 million, depending upon the industry in which the firm is primarily engaged.
- **Retailing** -- annual receipts do not exceed $2 million to $7.5 million, depending upon the industry.
- **Construction** -- general construction: average annual receipts do not exceed $9.5 million for three most recently completed fiscal years.
- **Construction** -- special trade construction: average annual receipts do not exceed $1 million to $2 million for three most recently completed years.
- **Agriculture** -- annual receipts do not exceed $1 million.

In the analysis that follows, these definitions have been adhered to in analyzing the data collected in our study.

Small Businesses comprise 95% of the independent businesses in, and make a substantial contribution to the U.S. economy. Statistics prepared by the SBA's Office of Advocacy in 1977 indicate that small business
concerns contribute:

- 43% of the Nation's national product;
- 48% of the Nation's gross business product;
- 64% of the Nation's total dollar volume generated by wholesaling;
- 73% of the Nation's total dollar volume generated by retailing;
- 57% of the Nation's total dollar volume generated by service industry;
- 96% of American enterprises gross less than $500,000.

In terms of the labor force, small business concerns employ 58% of the Nation's private, non-agricultural work force.

Small businesses play a crucial role in other areas of the business environment. While large corporations are able to mobilize greater pools of financial resources for R & D, and as a result account for a large share of innovative ideas and new inventions, small business also makes significant contributions. A study of new patents issuances showed that new patents were awarded to the following groups: Large corporations 33%; Individuals 33%; Small business concerns 33%. Secondly, new industries generally do not spontaneously appear. Rather they evolve growing from infancy to larger, more mature businesses. For the most part, the infant stages of such smaller industries are characterized by the existence of many smaller firms. Small firms are better able to cater to limited consumer demand when it is simply unprofitable for a larger firm to meet the needs of the market. It is the small firm which possesses the flexibility necessary to effectively serve unique patterns of demand.

While small business provides significant contributions to the economy, it is apparent that the vast majority of small businesses have severely limited financial and managerial resources at their disposal.

Ninety-eight percent of the total number of U.S. firms employ fewer than 50 people, 65% of all firms involved in manufacturing employ fewer than 20 employees, and 89% have fewer than 100 employees.¹

Ninety-six percent of American enterprises gross less than $500,000 with 66% of these firms grossing under $25,000.²

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SECTION II - IMPACT OF GOVERNMENT REGULATION

Because Federal Regulation affects each and every business within the American economy, it is important to examine their impact on small business concerns.

There are endless volumes of government testimony and research studies which conclude that government regulations impose an unfair burden upon the small business concern. Inappropriate regulation, excessive paper work requirements, excessive drains on managerial resources and disproportionately high costs of compliance are frequently cited burdens to small business caused by federal regulation. In addition, studies cite less tangible hidden costs such as reduced rates of new product introduction, decreases in product innovation, decreases in capital formation and loss of productivity.

In order to supplement the wealth of information already available on the costs of regulation, the Wharton Entrepreneurial Center designed and conducted a survey to examine several less explored areas of the regulatory process. Major efforts were directed towards surveying owners and managers of small businesses, regarding the following areas:

1. Communications
   Sources and quality of information available to the small business firm.

2. Costs
   Dollar and resource costs associated with researching and complying with government regulation.

2b. Growth Opportunities
   Effect of government regulation as a deterrent to growth through discouraging internal financial investment in new products or business and external acquisition.

2c. Psychological Costs of Government Regulation
   Small business availability to effect or have a voice in the regulatory process.

3. Regulatory Burden
   Identification of regulatory procedures or groups of regulations which small businessmen consider most burdensome.
SURVEY STATISTICS

Questionnaires were distributed to 332 small businesses from Pennsylvania, Southern New Jersey, Delaware, and Maryland. The 72 respondents (21.7% response rate) represents a diverse cross section of business. Respondents fell into the following classifications:

Service Industry
- Consulting
- Retail 8.3%
- Insurance
- Liquidation

Manufacturing
- Dental Products
- Consumer Products
- Lumber
- Computer Peripherals 59.7%
- Industrial Products
- Textile Products
- Chemical Products

Product Distribution
- Soft Drink
- Importer
- Dental Supplier 30.6%
- Other

Reported annual sales volumes ranged from $100,000 (Dental Supplier) to $25,000,000 (Chemical Specialty Manufacturer) with a mean annual sales volume of slightly over $5 million ($5,056,862).

Companies reported labor forces ranging from 2 employees to 250 employees with the average firm employing 89 individuals.

Communications

Shortcomings in the communications process between government and small businessmen provide one of the major obstacles to the small businesses in their ability to meet regulatory requirements. Inadequate communications channels prevent businessmen from obtaining relevant and timely information about government regulations which affect their method and mode of operation.
The Federal Register, the official vehicle by which regulatory information is communicated to the public, is considered complex and generally unreadable by the small businessman. Only 19% of our respondents used the Federal Register as a source of regulatory information. In addition, our findings indicate that the small business concern has neither the managerial resources nor the necessary legal background to first find, and then interpret legislation which impacts their business.

Of those firms responding to the Center's survey, 53% felt that they were inadequately informed of new and existing federal regulations which have an effect on their business. Not surprisingly, comments consistently cite lack of time, shortages of manpower, and complexity as major reasons for being aware of regulation. A small manufacturer, whose comments summarized the sentiments of many, stated: "It is unrealistic to assume that the small businessman has time to both run his business and spend his afternoons in ... the library ... The costs of obtaining this information by far exceed penalties which could be imposed for non-compliance ..."

Several respondents stated that they simply ignored regulatory change because of the high cost of obtaining information. One respondent simply stated: "We wait until their effect is brought to bear upon our operation."

Even in cases where businessmen were aware of regulation, 16% of our sample were penalized for violation of OSHA, IRS, and FDA regulations of which they were unaware. Typical comments indicated high levels of frustration:

"(To) Keep up with regulations is impossible, they are always changing and are so numerous that it seems clear that a self-serving bureaucrat is trying to justify his salary."

"(Our confusion comes from) a lot of overlapping and apparently conflicting regulations passed by different government agencies..."

An overwhelming majority of our respondents required outside expertise in order to interpret and comply with federal regulations (88.9%). Primary sources of information were ranked as follows:

<table>
<thead>
<tr>
<th>Source</th>
<th>Frequency of Mention</th>
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<tbody>
<tr>
<td>Trade Associations</td>
<td>80.6%</td>
</tr>
<tr>
<td>Accountants</td>
<td>69.4%</td>
</tr>
<tr>
<td>Attorneys</td>
<td>61.1%</td>
</tr>
<tr>
<td>Newspapers and Periodicals</td>
<td>50.0%</td>
</tr>
<tr>
<td>Federal Register</td>
<td>19.4%</td>
</tr>
</tbody>
</table>
Table 1. (continued)

<table>
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<tr>
<th>Category</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Trade Magazines and Publications</td>
<td>15.3%</td>
</tr>
<tr>
<td>Consultants</td>
<td>6.9%</td>
</tr>
<tr>
<td>Government Agencies and Publications</td>
<td>5.6%</td>
</tr>
</tbody>
</table>

It is apparent from these results that government agencies and their publications appear to be an inadequate source of information for the small businessperson (5.6%).

Not surprisingly, 66% of the businesses polled saw the need for government agencies to make additional information to the small businessmen in easily readable language that the layman can understand. The comments of those businessmen who were not in favor of agencies providing more information were generally interested in obtaining information but felt that increasing government activity in this area would not be helpful. Thirty-nine percent of those not interested in seeing more information cited poor quality and contradictory information as reasons for rejecting this alternative. This point of view was most clearly stated by one dental manufacturer: "There are mountains of brochures now available, but the public does not know where to look (to find them)...They are neither well written nor well organized..." Respondents also expressed concern that the federal government would respond to the need to make regulatory information available by creating another additional layer of government bureaucracy, further distancing the small businessman from the regulatory process.

Instead, small businessmen appear to turn to more costly sources to provide regulatory information. Approximately two-thirds of our sample rely on the services of accountants and attorneys to obtain information regarding the regulatory process. However, the high costs of these services drain important financial resources from the firm, which could otherwise be used for capital expansion programs and new product development.

Trade associations represent the most widely used source of information in our sample (80.6%). The high frequency of mention implies that if the federal government is going to improve its communication program, it must continue to support and work very closely with trade associations.
Costs

Cost examined in this study included:

Costs of obtaining regulatory information, lost growth opportunities (opportunity costs) and psychological costs.

Administrative Compliance Costs

Precise data pertaining to actual and percent of sales costs of obtaining regulatory information from internal and external sources is difficult to obtain. Many of those companies surveyed did not have accounting systems designed to provide cost information of this nature. Thirty-three companies were able to approximate the total dollar cost of complying to federal regulations in 1978. Costs reported by these firms ranged from 0 to $100,000 with the average cost of compliance at $12,215. On a percent of sales basis, these costs (when reported) corresponded to a range of 0.1% to 1.5% of annual sales. Average costs as a percent to sales were .5% of annual sales. Personnel resources assigned to complying with regulatory requirements ranged from .5 (part time) to 9 employees per firm. The average firm required approximately three people to comply with federal regulations. Regulatory requirements necessitate an average of 3.5 hours of top management and owner/manager attention weekly.

When examined in a vacuum, these reported administrative compliance costs do not appear to be particularly burdensome. However, if one assumes that the primary resource in a small business is the expertise and attention of the owner or top level managers, one can reasonably impute that diversions of managerial resources are likely to have more serious effects than on their larger corporate equivalents.

Growth Opportunities

Lost growth opportunities and opportunity costs are of major importance to the small business. Time delays caused by the regulatory process have had a severe impact on the heavier regulated industries. Several small dental manufacturers commented that they have stopped new product introduction and innovation due to the high cost of required testing procedures necessary for products that are non-health related, yet fell under FDA regulation. In addition, they felt that they could not afford to invest in new products because of the long interim period where they would
receive no return on their investment. A substantial proportion of our sample fell into this area. In all, 37% of the businessmen responding to this survey stated that federal regulation had delayed or prevented the introduction of new products or services. Those companies reporting delays ranged from 2 to 48 months with a median delay of 13.8 months.

Forty-eight percent stated that federal regulation had caused them to reject a financial investment in a new product or service which they ordinarily would have made. High fixed costs associated with required equipment (i.e., pollution controls), time delays and expensive and prolonged testing procedures were given as reasons for rejection.

In terms of scale, 25% felt that federal regulation was responsible for a reduction in the scale of their operation. While respondents estimated that their operations decreased in scale from three to 500% due to federal regulation; several manufacturers cited increases in scale suggesting that regulatory compliance in a very small way is creating new small businesses.

**Psychological Costs**

Psychological costs have been said to affect the small businessman in three areas. Areas affected include:

- Governmental Relations
- Managerial Independence
- Enjoyment of doing business.

In evaluating these costs, we looked for qualitative assessments drawn from the tone of comments as well as responses to specific questions. Most significantly, 96% of our sample felt that federal regulation did not adequately consider the realities confronting the small businessman. And 62% felt that they did not have adequate channels through which to influence legislation which has an impact on their business. Of those feeling that they could affect the legislation process, Trade Associations, legislators and the Chamber of Commerce were frequently cited modes.

The government/small business relationship can best be termed an adversary relationship. Dealings with federal employees and agencies were described as "a hassle," "self centered," "impressed with their own power," "absurd," "unrealistic," "arbitrary and capricious," "bureaucratic,"
"nitpicking," "lacking flexibility," "uneffective," and "burdensome." As one businessman stated,...we work under 'psyched-out' conditions most of the time, feeling depressed that the axe will fall tomorrow."

**Regulatory Burdens**

Of the businessmen responding to the survey, 56% felt that federal regulation put them at a competitive disadvantage in relation to larger firms in their industry. Reasons mentioned for this inability to compete were economics of scale where capital expenditures were required for compliance (i.e., political controls), shortages of capital resources, higher costs of financing, and smaller management organizations.

IRS regulation was selected as the most burdensome type of federal regulation. Complicated and time-consuming reporting techniques were mentioned on numerous occasions. In addition, repeated audits by inexperienced personnel were reported by businessmen as drains on managerial and financial resources.

OSHA regulations were considered the second most burdensome group of agency regulations. Several manufacturers reported receiving fines for violating OSHA regulations which they were unaware of. Another cited OSHA regulations as confusing and contradictory (i.e., loud horns on fork lift trucks while requiring employees to wear ear-muffs). Complex and confusing ERISA (Pension) regulations ranked third most burdensome. While ERISA regulations were originally designed to protect the employees in large pension programs, high regulatory compliance costs have had a negative impact on those individuals whom the regulations were meant to protect. Several small businessmen stated that they have dropped or severely cut back their pension/benefit programs due to complicated ERISA regulations.

**TABLE 2**

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<thead>
<tr>
<th>Most Burdensome Regulations</th>
<th>Frequency of Mention (%)</th>
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<tr>
<td>IRS (Internal Revenue)</td>
<td>22%</td>
</tr>
<tr>
<td>OSHA (Occupational Safety)</td>
<td>18%</td>
</tr>
<tr>
<td>ERISA (Pension)</td>
<td>15%</td>
</tr>
<tr>
<td>FDA (Food &amp; Drug)</td>
<td>13%</td>
</tr>
<tr>
<td>EEO (Equal Employment)</td>
<td>8%</td>
</tr>
<tr>
<td>CPSC (Consumer Product Safety)</td>
<td>8%</td>
</tr>
<tr>
<td>Government Contracts</td>
<td>7%</td>
</tr>
<tr>
<td>Other</td>
<td>9%</td>
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</tbody>
</table>
The federal regulatory burden was expressed by one retailing executive as, "No single regulatory measure is, and of itself, too onerous, but the cumulative effects add countless hours of clerical work to the cost of doing business."

Perhaps the overall burden of government regulation was most appropriately expressed by: "...many federal and state rules and regulations have sound goals and objectives (such as clean air, clean water, protection of workers, benefits, etc.); however, instead of dealing with the basics in a simple, straightforward manner, each federal bureau or department seems to be attempting to establish its own kingdom with the result that we have overlapping contradictions and tons and tons of unneeded and unnecessary paper work ... We should not kill the good intentions but we must simplify, condense, and make sense out of what we are creating." (emphasis added).
SECTION III - CONCLUSIONS AND RECOMMENDATIONS

The purpose of this paper was to study the impact of federal regulations on small business. The questionnaire, which was issued and completed with these results indicate certain problem areas. It is the intention of this section to explore and determine possible courses of remedial action.

It is, of course, understood that federal regulations exist for a purpose. Were this not the case, the obvious manner in which to relieve federal burdens would be simply to eliminate regulations.

Thus, it is necessary to strike a balance between the general public interest and the interest of small business. In a preponderance of instances, the regulatory impact can only be made less severe at some cost. If EPA restrictions were loosened for small firms, more pollutants would fill our air and water. If ERISA reporting requirements were reduced, employee pensions rights would be safeguarded to a lesser degree. Thus, the stereo-typical cries of "too much government" do not do justice to the complexity of the situation.

But one should understand that it was not until the early seventies that the regulatory burden upon small business increased in severity. At this point, there was a gradual recognition of a problem and, apparently, a growing willingness to address it. In the past few years, affirmative action has been taken in certain areas to improve the situation. But it seems incumbent upon those who have indeed expressed a concern for the situation to broaden the attack. Small business will be the immediate beneficiary of such an effort. The general welfare of the nation will also be enhanced along with the help of small business due to lower prices, greater productivity, increased employment opportunity, and continued innovation in the small business sector.

Based on the conclusions from the questionnaire, there are certain recommendations which emerge, and these recommendations are designed to address some of the problems. No single suggestion should be construed as a panacea. Each may serve as a model upon which further recommendations may be formulated.
Communication

Government agencies should become more actively involved in the dissemination of material which clearly and completely explains regulations rather than relying on the Federal Register as the sole source of information.

Regional offices should be established where teams of consultants are available further to explain regulations, suggest methods of compliance, lend general expertise, and be readily available.

It would appear that those who propose and implement the regulations are not adequately aware of the real impact federal regulation has upon this sector of the business community. In few instances is the voice of small business introduced at an early stage in the regulatory process.

Trade associations should be encouraged to participate in the communication process by the provision of free postage and free printed material. Since it appears that lawyers and accountants are the most frequent sources of information regarding federal regulation for small firms, special efforts should be made to induce these firms actively to participate in the communication process.

Trade associations should also be encouraged to establish workshops with the aim of simplifying federal regulation for its members and also to be the bridge facilitating communication and to provide feedback regarding the effect of federal regulations.

Compliance

It has become obvious that compliance is a costly feature in the operation of small businesses. Low cost loans should be provided in order to comply with these regulations. This is especially true since the cost of capital is generally higher for the small firm than for the large.

Emergency financial relief might be made available to firms whose existence is threatened by the impact of federal regulations. In certain instances, it might be appropriate to shift the cost of compliance to the public sector in order to maintain the viability of the small businesses affected.

Flexibility should be allowed by concentrating on the general objective of regulations rather than satisfaction of detailed requirements.
Agencies should recognize that the ultimate end is not adherence to specific regulations but rather the achievement of some overall condition. The concern which has been oft times expressed is the need to eliminate unnecessary or duplicative paperwork and consolidation of forms.

**Enforcement**

Some type of flexibility in the enforcement pattern should be permitted. Agencies should allow certain exemptions or, while defining standards, allow some violations to go unpunished. (For example, OSHA currently allows the first nine non-serious violations to go unpunished.)

There appears to be reason for consolidation of inspections, and this would mean that there would be less time needed by the business firms to comply with many of the rules and regulations which are duplicative in their demand for inspections and reporting.

It may well be that a program of self-policing might also be appropriate as a strategy for the enforcement process.

**Efficacy**

Some group, whether it be the Small Business Administration or some other which is newly formed, should be the spokesperson for small business. The voice of the small business sector should be afforded adequate attention.

Advocacy should be encouraged from the private sector, and this should, obviously, come about both from the point of view of government as well as from trade associations and the business community itself.

Large firms have lobbies and law firms as well as staff which have the resources in order to provide internal assistance to meet the demands and the impact of federal regulation. Small businesses do not. This deficiency characteristic of small firms should be addressed.

**Common Sense**

In summary, the plea which is most pervasive in the comments and suggestions of small businessmen in our survey was for a common sense
approach. Businessmen realize the necessity of federal regulation and support the spirit under which regulations are conceived; however, it is imperative that design and enforcement consider the limited resources of the small businessmen in America.
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