April 9, 2008

Testimony for the House Committee on Small Business:
Subcommittee on Investigations and Oversight:
10:00 a.m. Room 1539 Longworth House Office Building.

"Impact of Rising Gas Prices on America's Small Business"

I want to thank the committee for the privilege of providing some insight into the impact the rising fuel prices are having on small businesses, as well as their employees and consumers. As my vita indicates I have had a diverse career that includes education, journalism, small business and corporate America. I have been both a one man advertising and marketing research firm that grew to 5 employees and turned a restaurant idea into a public company where I served as Chairman & CEO, that operated coast to coast, employing 4000 with sales approaching $2 billion over 22 years.

The simple fact is virtually every product bought or sold in America winds up being transported in a car or truck at some point in the consumption process. Thus, rising gas prices affect everyone and every business. Many distributors have instituted fuel surcharges to cover the increased costs of transportation. Most small businesses are left with no choice but to absorb those costs. Thus fuel prices have a multiplier effect since rising prices affect the cost of doing business for the company as well as the cost of living for the consumer.

Historically, small businesses run thinner margins than do larger competitors. Small businesses have less leverage in negotiating product pricing, transportation, marketing and labor costs. There are two simple choices to reverse declining profits or minimize losses. We either cut costs or increase prices. Historically, small and large businesses attack rising prices or shrinking profits by cutting labor costs because it is one of the largest cost centers for most businesses.

When I was faced with shrinking profits or losses, like many small business owners the first salary I cut was my own.

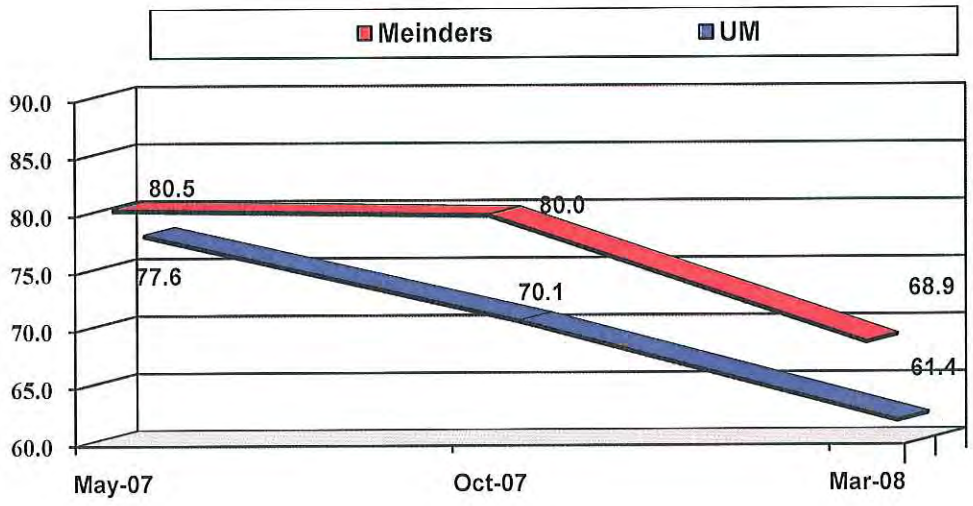
Inasmuch as the American economy is driven by consumer spending, when unemployment increases, consumer spending will likely decline. If you earn less you spend less. The overwhelming number of businesses in the U.S. are small and, thus, most likely to suffer during economic contractions.

The Meinders School of Business at Oklahoma City University conducts a regular series of consumer confidence polling (MSB Survey) to ascertain a scientific measure of consumer attitudes in 16 'Middle-American' states surrounding Oklahoma. The March 13-16, 2008 poll was conducted under the direction of Professor of Economics, Dr. Steven Agee who is also a member of the board of the Oklahoma City Branch of the Federal Reserve Bank of Kansas City.

Polling results were provided to Tom Hoenig, President of the Federal Reserve Bank of Kansas City prior to the start of the FOMC meeting on Tuesday March 18, 2008. (Executive Summary Attached)

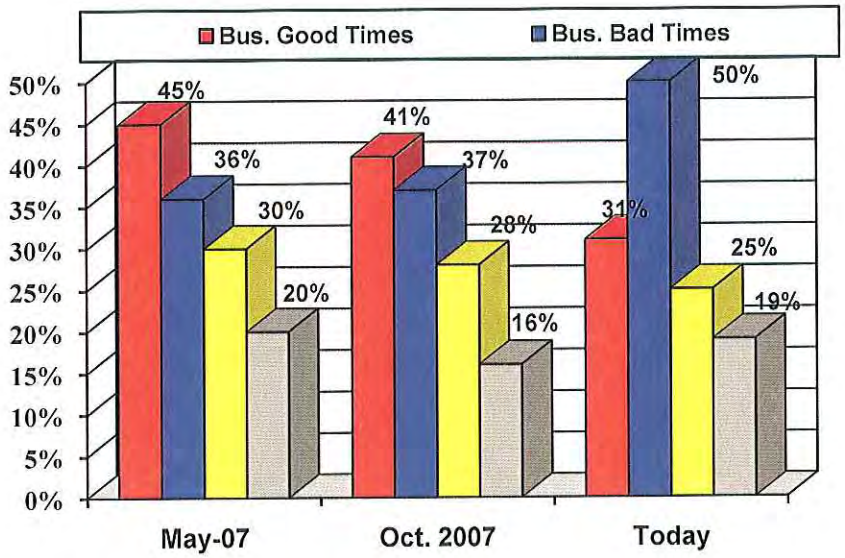
a. The MSB Survey indicated a 'dramatic shift in consumer attitudes since last October and results of the most recent University of Michigan Consumer Sentiment Survey. (MSB 2)

CONSUMER EXPECTATIONS



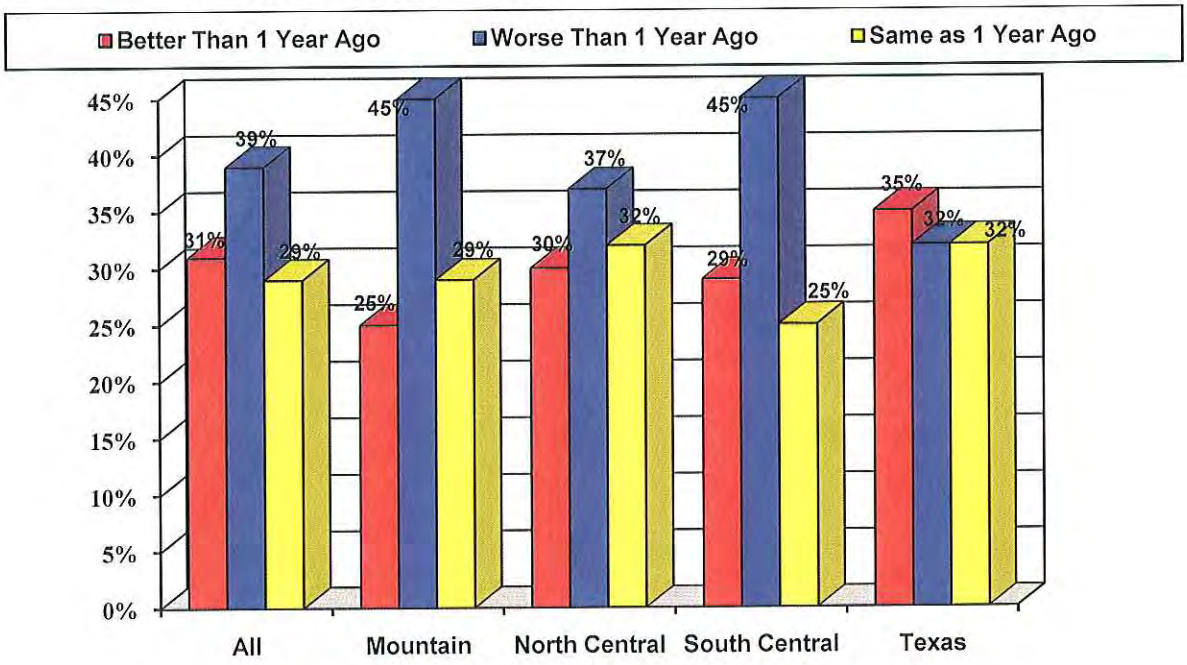
b. 50% of consumers in middle America believe the coming year will be bad for business, up from 37% in October 2007 and 20% in May 2007. (MSB 3)

Business & Personal Expectations



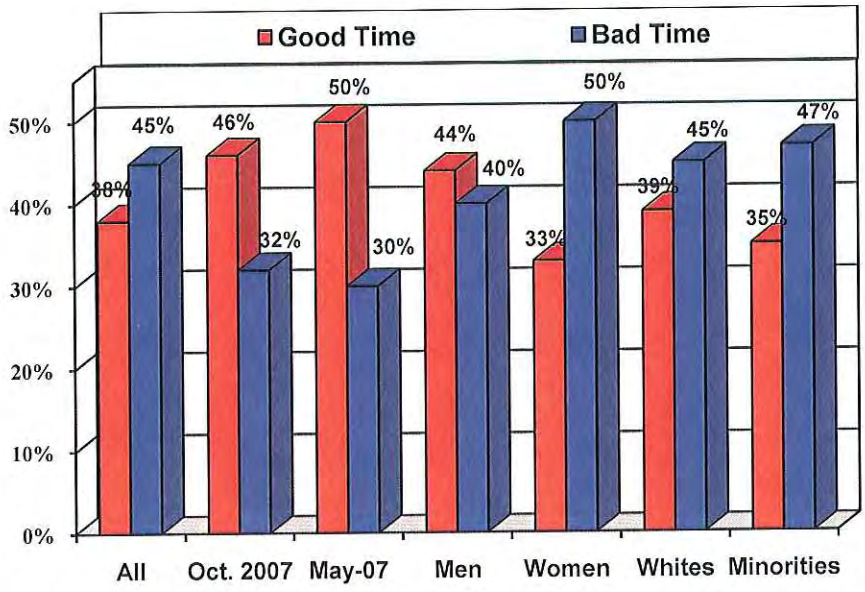
c. 39% of the respondents believe their financial situation is worse than a year ago. 47% of consumers believe the next five years will bring periods of depression vs. 37% in October. (Women are more pessimistic than men (51% vs. 43%). (MSB 3A)

CURRENT FINANCIAL SITUATION BY AREA



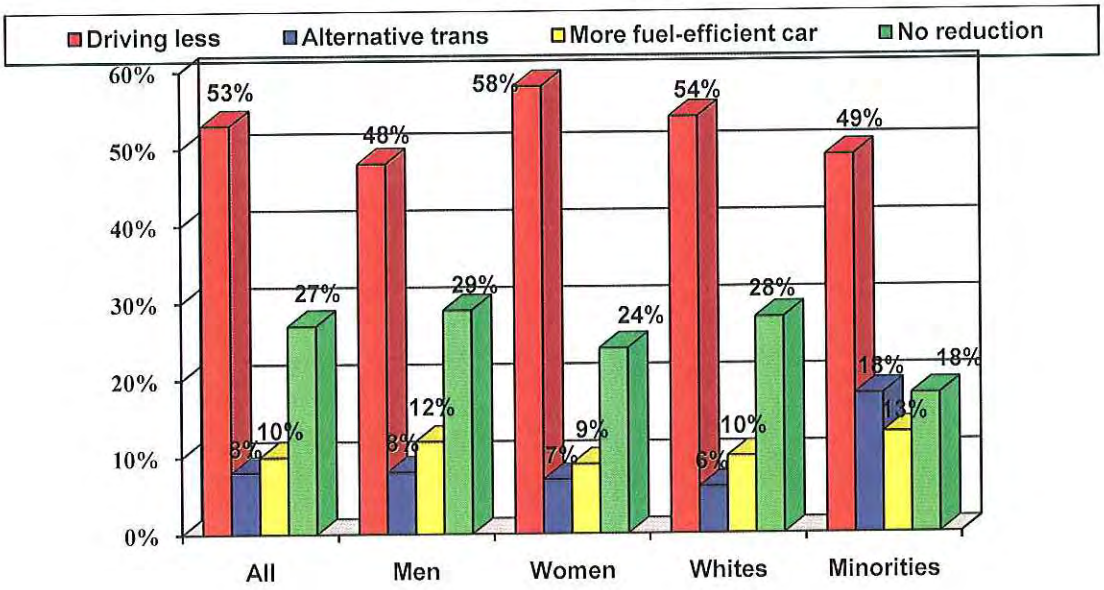
d. There was a decline in those thinking now is a good time to buy a durable household item, 38% vs. 46% last fall. (MSB 4)

GOOD TIME FOR HOUSEHOLD PURCHASES

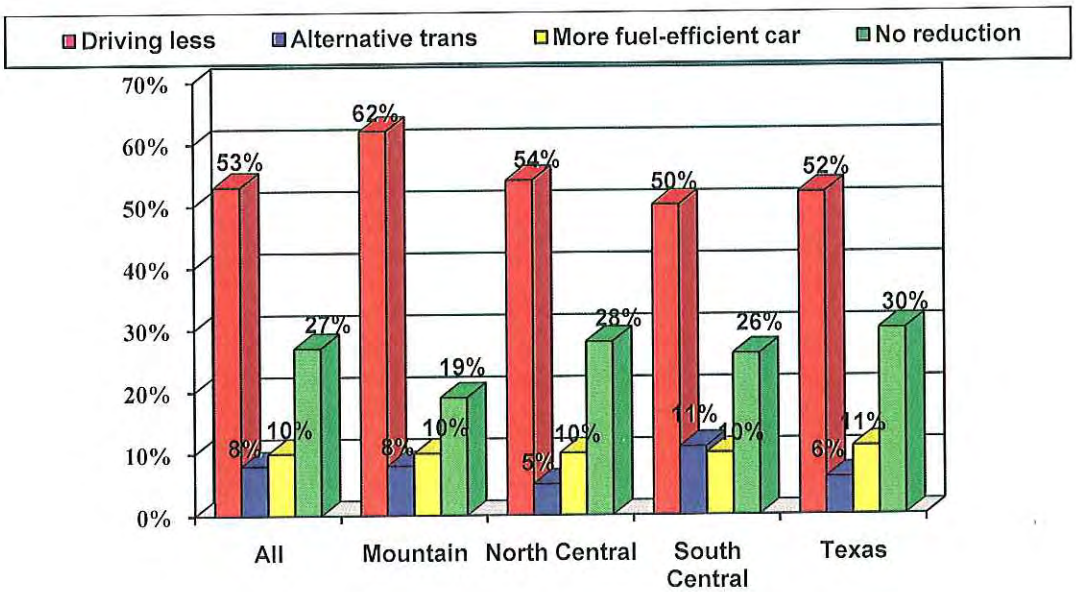


e. Consumers continue to change their habits as a result of higher gasoline prices. 53% of all consumers (vs. 58% women) say they are now driving less. (MSB 5 & 6)

DEALT WITH GAS PRICES



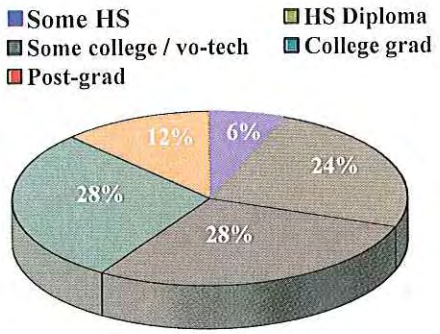
DEALT WITH GAS PRICES BY AREA



The Meinders Consumer Confidence Survey is similar to the oft-quoted University of Michigan Consumer Sentiment Survey. Data collection methodology differs from the UM survey but the formulas for calculating the index are the same, allowing comparisons to be made. Poll Demographics by state/education. (MSB 7)

POLL DEMOGRAPHICS – STATE / EDUCATION

Arkansas	4%
Colorado	7%
Iowa	5%
Kansas	4%
Louisiana	6%
Minnesota	8%
Missouri	9%
Montana	1%
North Dakota	1%
Nebraska	3%
New Mexico	3%
Oklahoma	6%
South Dakota	1%
Texas	33%
Wisconsin	9%
Wyoming	1%



SBA numbers document some of the problems already occurring. **Business bankruptcies** have risen for the last four quarters at the same time the **Small Business Optimism and Consumer Sentiment indexes** (SBA 2708) were both declining. This has resulted in small business owners significantly reducing their hiring plans.

Inflation is impacting consumer prices. At $3 a gallon, consumer discretionary income declines enough to impact the frequency of eating at quick service and casual theme restaurants, which alone are reported to have lost more than 10% of their customers. Soft good purchases at chain stores (many operating as small business franchises) and thousands of independent merchants are down along with ticket sales at movie theaters. This is consequence of higher gas prices reducing the number of consumer discretionary dollars. This not only impacts small businesses providing these products and services, it also affects suppliers to these businesses whose profits are also squeezed by the increasing price of gas. History tells us this economic trend will and in fact is leading to an increase in unemployment, which further exacerbates the problems facing small business.

Given the fact the members of this committee are from Arizona, Texas, Pennsylvania, New York, Georgia and Oklahoma...states overwhelmingly populated by small businesses as well as many working blue collar citizens, your efforts to help reduce the price of gasoline and would directly impact your communities.

Small businesses are also the starting place for many minorities, women and immigrants who already face social and economic challenges. Rising fuel prices pose an enhanced threat to small businesses owned by members of these groups, at the very time we are encouraging diversity. Rising fuel prices have resulted in poor sales, declining profits or losses at Macy's, Wal-Mart, Sears, Wilson Leathers, Applebee's, (along with the thousands of small 'mom & pop' restaurants), not to mention high end stores such as Nordstrom's.

Liz Claiborne is shuttering 54 Sigrid Olsen stores, Ann Taylor is closing 117 of its 921 stores, Talbot's has closed all its men's and children's clothing stores along with 22 women's stores. Even Target and Starbucks are seeing a slowdown. Demand is down because discretionary income is down. Each of these chain operations are serviced by countless small businesses that provide window washing and custodial services, paper products, delivery, alterations and many other services that will be impacted by what many chains are experiencing. Vacancy rates at regional shopping malls have increased dramatically. National retail vacancy rates rose for the 11th straight quarter, to the highest level since 1996 with another 34 million square feet of space under construction....which will lead to even larger vacancies problems. All of this paints a dark picture for small businesses across our nation.

Corporate defaults, bankruptcies and rising fuel prices threaten our nation's airlines along with hundreds of smaller businesses who support the airline industry. Companies like Blockbuster, Ryan's Steakhouse, Old Country Buffets's, Landry's Restaurants, home builders, mortgage lenders and trucking firms are also struggling to survive. The current housing market could exacerbate small business problems. A slow down in homes sales translates to a slow down in the sales of furniture, appliances, lawn and garden products and countless service industries.

Recently members of congress called in leaders of America's energy industry to discuss high oil prices. As a former Chairman and CEO of a public company I can tell you the responsibility of every CEO is to maximize profits. To do otherwise would cheat shareholders who own these stocks or have them invested in their 401K. Criticizing the oil industry for being successful is not the solution to high oil prices. China, India and a host of other nations have significantly increased demand and therefore the price of oil. America's leadership in the energy industry is being challenged by the Chinese and Russians and both are enjoying new economic, political and military power as a result of their oil industries.

Over the last few years OPEC has reduced oil production to keep oil prices high. What makes matters worse is the fact OPEC only has a 2-3 million barrel a day production capacity surplus (MSB 8) and a weak dollar means dollar based economies are experiencing higher oil prices than those with other currencies. (MSB 9)

In the face of these economic realities, it is in America's best interest to have as strong an energy industry as possible. Profits are plowed back into research and drilling which results in job creation and more often than not, high paying jobs.

Since the government didn't provide much help to America's energy industry when oil prices were $20 it shouldn't criticize or penalize it now because oil is $100. Price is a consequence of demand and world demand is higher than ever. America's oil industry competes in a global market place and should be encouraged to use its genius to find more oil and new alternative sources of energy.

Congress would do well to encourage these companies to invest in a new 'Manhattan Project' effort to finally make our nation energy independent. While it's not easy to put a good face on high oil prices the good news is it does provide sufficient incentive to spur increased growth for alternative energy sources as well as increased but more expensive and riskier drilling.

Many of America's farmers and ranchers are correctly defined as small businesses. They not only face higher fuel prices, they are also facing higher prices for chemical fertilizers used to grow their crops. Many of these farms and ranches also receive royalties from oil and gas wells on their property. One positive to higher oil and gas prices is higher royalties which are helping many farmers offset the increased costs of operating their businesses.

Make no mistake about it, an old stripper well that wasn't worth operating at $20 a barrel might now be generating $1000-$2000 a day, some of which is paid to those farmer-rancher royalty owners.

There is no short term or easy solution to high gasoline prices. We need more exploration and more refinery capacity both of which are made difficult by government regulations and prohibitions. We need to improve automobile fuel economy standards which have remained the same for about two decades. There is one quick fix that would benefit consumers and small business owners. Congress could reduce federal fuel taxes which would have an immediate positive impact of about 50 cents per gallon and would be quicker and easier than mailing rebate checks to 170 million households.