



THE SME SOLUTION  
PROPOSAL

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## The SME Solution

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The State of California Commerce Web site carries an unassailable truth:

California SMEs ...

***Provide a pool of entrepreneurial experimentation  
from which successful firms emerge.***

California has long been the leading entrepreneurial edge of the Nation, and now that entrepreneurial spirit has taken hold all across the country, even in small towns deep in the heart of rural America.

Another true statement is:

***Inside every small company CEO is a mid-size company waiting to grow.***

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The purpose of this document is to define the reality of SMEs and suggest a way to provide growth capital opportunity as well as appropriate protection for investors/shareholders. This document will cover:

- The sensible solution
- Size of the SME market
- Growing popularity of SB-2

### 1 The SME solution

As will be shown later in this document, the SME market in the United States is huge, growing, and finding growth capital difficult to obtain. For this reason it is increasingly looking to SB-2 registrations as an appropriate source of funding.

For the SEC, this poses a significant problem if regulatory oversight continues to operate the way it always has operated, but a simple change in the way things are done will provide great benefits to the US economy as well as solve the problem of SME regulatory oversight. In recent years the advent of EDGAR and online filings has improved efficiency in collecting and processing company information while making it possible for the SEC to provide transparency to every investor who seeks company information. The SEC must now build upon the EDGAR system and create a true quantum leap that will result in attracting investors from all over the World to US markets in greater numbers than ever before.

Since the advent of Sarbanes-Oxley, hundreds of software companies have developed enterprise systems that communicate with all the popular accounting applications, all the popular word processing and spreadsheet applications, and also communicate with EDGAR.

**Adopting an SEC-sponsored enterprise system and making its installation at all SME public companies a requirement of registration, whether trading on the Pink Sheets or the OTCBB, would accomplish the following:**

- Standardize and make more efficient corporate reporting
- Provide transparency even in the smallest public companies and remove the Pink Sheets stigma of questionable corporate veracity
- Make the US markets the most trustworthy in the World because US equities, particularly the growing companies that are our future, would be the most transparent and likely the best managed in the World
- Increase the operational efficiency of public SMEs through the proven benefits of internal information management and analysis to the planning and decision making process via enterprise systems
- Transform the American SME into the most modern and efficient in the World
- Reduce the cost of compliance for SMEs

Selection of systems - With so many excellent systems customized for all industries already available in the enterprise application marketplace, the SEC might want to select several different providers. Some public SMEs already use enterprise systems

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that may have to be tweaked to interface with the SEC's selected systems, but tax credits can certainly take care of those extra costs and insure the companies' cooperation in altering their systems. In many cases, there will be very little difficulty encountered.

Key to success - To encourage rapid adoption of the SEC-sponsored enterprise systems, modest license fees could be included in the regulatory fees. The key to success is in providing these systems and training inexpensively, taking advantage of volume adoptions to make the provision of these systems financially appealing to the vendors.

Economic benefits - The widespread adoption of these enterprise systems will have the added benefit of providing many thousands of jobs with the attendant increase in income tax revenues as well as bringing funding to the street-level consumer who is currently awash in debt, curtailing consumption.

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### 2 Size of the SME Market

According to McKinsey & Company, in 1997 SMEs generated \$33-billion a year in profits for banks handling their simple checking, credit, and funds management needs; and banks that serviced SMEs found that their ROI for this target customer was over 30%, while consumer lines generated ROI at a fraction of this level. In terms of their broader business financial needs, SMEs accounted for an additional annual \$50-billion in profits. The ancillary market space resulting from products and services targeting the personal needs of SME founders, executives, employees, and their families added additional total profits of \$122-billion making the small business market worth over \$200-billion to banks alone.<sup>1</sup>

Adding future fuel to the SME market is the expected transfer of wealth through estates, which will exceed \$400-billion by 2006.<sup>2</sup> Since 1995 the small business sector of the economy has grown substantially owing to two factors: the Internet, and corporate hiring of a greater percentage of independent contractors. With so many in this space, a percentage of inherited money will naturally be spent to expand these already existing businesses.

SMEs provided 80% of net employment growth in the period 1992 through 1998, according to McKinsey<sup>3</sup>. There are approximately 25 million small businesses in the United States. By virtue of their size, small businesses have greater flexibility and are quicker to respond to new opportunities than larger firms. They employ just over half of all private sector workers, pay 44.3 percent of total U.S. private payroll, create seven out of 10 net new private-sector jobs in America and account for more than half of the output of our economy. Total small business wealth amounted to \$8.3 trillion, accounting for 42.8 percent of total business wealth of \$19.4 trillion in 2000.<sup>4</sup>

IBM, American Express and Microsoft (examples of large companies successfully scaling their services to the SME market) for the past several years have been gearing products and services to this market segment with increasingly impressive results as have a host of software firms, payroll processors, office product retailers, credit card companies, and service providers seeking to provide the advisory and management knowledge SMEs need. In truth, nearly every service offered to big business can be scaled to benefit the SME.

Still, growth capital is scarce for these companies. This is partly because of the lack of liquidity for private investments. A solution now receiving greater appreciation from regulatory bodies can be found in the expansion of SME capital markets, allowing the transparent exchange of equity ownership through Pink Sheet and OTCBB trading via SB-2 registration. This attitude change in itself promises to add

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<sup>1</sup> McKinsey Quarterly, *Banking For Small Business: Will More Competition Destroy The Returns?*, Terri A. Austerberry, Jeffery S. Brown, Pacy P. Ostroff, 1997 Number 2

<sup>2</sup> *The Millionaire Next Door*, Thomas J. Stanley, William D. Danko.

<sup>3</sup> McKinsey Quarterly, *Chicago Thinks Small*, by Margo Georgiadis, Elizabeth E. Joseph, and David J. Keeling, 2001 Number 4

<sup>4</sup> Small Business Administration, *The President's Management Agenda Results Report*, August 2004

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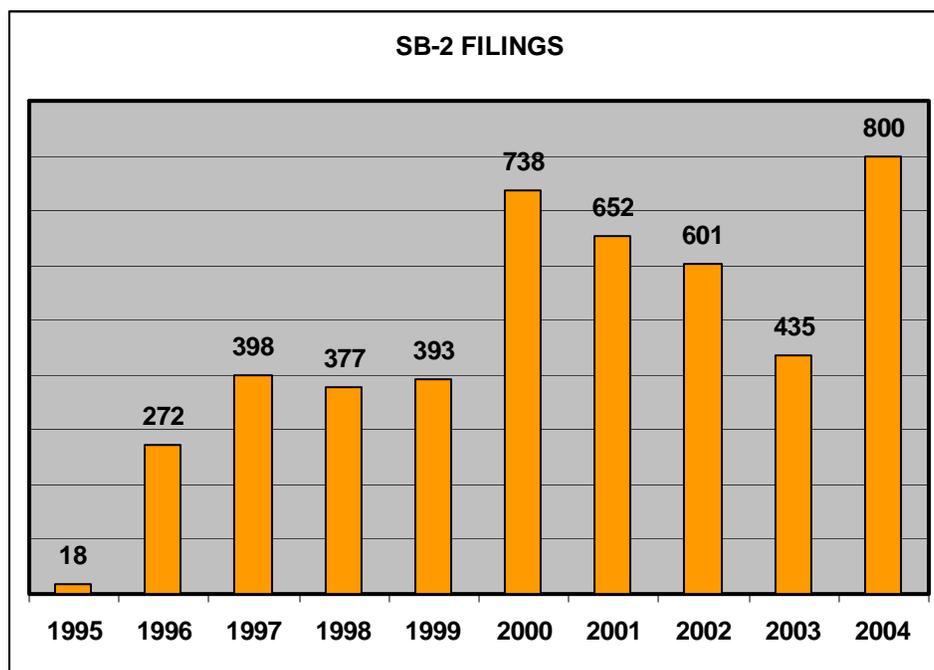
to the growth of this market space and to the opportunities for service providers who sell into that space or who scale their services to meet the demands of SMEs.

<b>SOURCES OF GROWTH CAPITAL</b>		
<b>Source/Type of Funding</b>	<b>Funds Available</b>	<b>Notes</b>
<b>SB-2</b>	Limited only to the amount that the marketplace will provide	<p>Management through holding a controlling block of stock can retain control of company.</p> <p>Additional funding available through issuance of additional stock.</p> <p>Provides investors with an easy exit for all or part of their holdings through selling their stock on the public market.</p>
<b>Venture Capital</b>	Generally available to only certain companies within certain industries. Amounts generally range from \$250,000 to \$10-million.	<p>Significant impact on ownership / management of company. VC normally requires a large or controlling interest in return for the money invested.</p> <p>VC may sacrifice company in order to benefit VC's other portfolio companies.</p> <p>Additional funding may not be available.</p>
<b>Banks</b>	Normally limited to small amounts in the form of collateralized loans. More appropriate for funding receivables and purchase of plant / equipment than for general growth purposes.	<p>Additional funding may not be available.</p> <p>Collateral subject to being seized for liquidation in the event loan is called due to late payments.</p>
<b>Friends &amp; Family</b>	Generally small amounts.	Death or financial need of an investor may force the company to return investment at a bad time.

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### 3 Growing popularity of SB-2 registration

In the decade 1994 - 2004 there have been 4,684 SB-2s filed as shown in the following chart:



In the year 2005 alone, by the end of May there had been 339 SB-2 filings, and if past experience indicating a rapid rise in the rate of filings during the Third and Fourth Quarters holds true, 2005 is well on the way to meeting or exceeding 2004's record.

Clearly the SB-2 is rapidly becoming the solution of choice for SMEs in need of growth capital. While the economic destruction of 9/11 clearly dampened the growth rate and Sarbanes-Oxley created a reluctance on the part of SME managers to move forward in what was a confusing regulatory environment, three circumstances have encouraged SMEs to continue their enthusiastic use of the SB-2:

- The economy has improved for SMEs making growth capital vital to their ability to expand into the better business environment,
- More accountants, attorneys and consultants have attained a level of comfort with and working knowledge of Sarbanes-Oxley provisions, and
- The SEC has recognized the need to study SME needs with the intention of creating rules and regulations customized to this group of companies in order to make capital raising activities easier while still maintaining protection for stockholders<sup>5</sup>.

<sup>5</sup> SEC announcement December 16, 2004: The Chairman of the Securities and Exchange Commission ("Commission"), with the concurrence of the other Commissioners, intends to establish the Securities and

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### 4 Conclusion

Selection - The SEC should create a SME Information Technology Task Force to research and select appropriate enterprise systems that communicate with the major accounting and office suite software as well as the EDGAR system.

Implementation – The SEC should require the installation of its selected systems in all public SMEs and should charge a modest licensing fee as part of the fees involved in registration. All new registrations would be required to install the appropriate enterprise system prior to registration.

Job Creation – Installation, maintenance and training would create substantial new jobs in the under-employed tech sector and would provide impetus for colleges and universities to retain and expand technology courses.

Pricing – The volume of installations would provide an incentive for developers to offer licenses at a reduced price. The SEC should be the primary licensor and should sub-license out to SMEs. Pricing could be scaled to the size of the SME.

Eligibility – Once an SME has grown beyond a defined size, its ability to access the sponsored program would be curtailed and it would have to provide its own enterprise system or take on full licensing.

#### Results –

- By creating a direct flow of information, the SEC could better monitor the state of the SME universe – particularly if the data flow occurred on a real-time basis.
- Filters can flag anomalies in reports, creating a more efficient oversight, and real-time automated reporting would save SMEs money and time.
- Accounting firms and auditors could interact with this data flow prior to direct submission and that would further streamline the process and not only make their jobs easier but would allow them to service more clients.
- Investors would have real-time transparency in evaluating companies for investment
- Data collected will provide a valuable tool for monitoring the state of the economy.

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Exchange Commission Advisory Committee on Smaller Public Companies to assist the Commission in evaluating the current securities regulatory system relating to disclosure, financial reporting, internal controls, and offering exemptions for smaller public companies. (<http://www.sec.gov/rules/other/33-8514.htm>)

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**Victoria Duff** is the founder and CEO of California-based business consulting firm, Bold Ventures Group ([www.BoldVenturesGroup.com](http://www.BoldVenturesGroup.com)), that specializes in new venture planning and launch for public and private companies under \$500-million. Besides her business consulting and financial experience, she has established herself as an active leader in the Internet industry where she has served in leadership roles with various industry trade organizations. One of the first executive women on Wall Street, Ms. Duff spent 20 years as an Institutional Bond Broker. She has occupied several C-level positions with her client companies over the years, and also served as Vice President and Asset/Liability Manager at Eureka Federal Savings, where she played a key role in the post-deregulation reorganization of the institution. She currently serves as contract COO for Public Company Management Corporation (OTCBB: PUBC). She also serves on the Boards of Directors of the prestigious Digital Coast Roundtable, the CEO Council and America's Baby Cancer Foundation, among others; and on the Advisory Boards of several public and private companies. Ms. Duff is a well-known speaker and writer on business topics, having written columns for *Developments Magazine*, the *Digital Coast Reporter*, *@association* and *la vox*; and currently runs the Bold Ventures Business Discussion List on YahooGroups. Ms. Duff earned her Bachelor's Degree in public administration from the University of California, Berkeley.