Statement by Matt Stoller

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For the United States House of Representatives Committee on Small Business

on

"The Impact of Coronavirus on America's Small Businesses"
March 10, 2020

Thank you for inviting me to make a statement on the current situation regarding small business and the Coronavirus. My name is Matt Stoller, and I am the director of research for a nonprofit organization called the American Economic Liberties Project. We are a network of scholars, reporters, advocates, and business leaders who research and advocate around the problem of concentrations of private power.

To prepare this statement, I asked our network two basic questions relating to the current crisis. The first question is immediate. How is the coronavirus affecting your business? The responses are entirely anecdotal. The second question is more long-term and has to do with supply chain dependencies. Why is it so difficult to produce the things that we need, such as medicine or electronics, in this country?

This statement is accompanied by two spreadsheets and a list of comments from people in affected businesses who answered either question. The first spreadsheet is a list of drug active ingredients that are manufactured in Hubei province, which was hardest hit by the virus. The second spreadsheet is a list of complaints offered from 2017-2019 to the United States Trade Representative by corporations and stakeholders about the 301 tariffs levied on China. These corporations often decried proposed tariffs because of their dependence on Chinese industrial capacity, providing an incomplete but potentially useful list of products upon which American industry is dependent. My organization is providing this information to offer some evidence on the depth of our supply chain dependency on foreign, and particularly Chinese, production.

How is the Coronavirus affecting small business?

There are three basic impacts we are hearing about so far. First, the travel and tourism industries are being hard hit, because few want to gather in groups or take airplanes. Second, conferences are being disrupted, in particular vendor showcases, which leads to an inability to launch new products. Third, there is a dramatic hit to productive capacity and confidence even among businesses outside of directly affected areas. These businesses are reducing non-essential travel and spending and attempting to secure critical supplies from affected countries.

Many businesses and workers in our network are having problems because conferences are being canceled. One music promoter told me she is going to be significantly damaged by the cancelation of major music and tech event South by Southwest. Others are noting that expos for new product displays aren’t going to happen, which means that orders won’t come from distributors.

Others are having problems producing. Here’s a note from someone in Washington state.

> We have a business where you can't really 'work from home'. It's producing, manufacturing, shipping, receiving. I emailed my Senators (Murray and Cantwell) to tell them they need to get way out in front of this. If this continues like this with closings, social distancing, hoarding, we may be heading toward a Depression. Small businesses will be closing en masse.

This note is from one business leader outside of the directly affected tourism and travel industries.

In the domestic premium steel/metal producer where I work, the fear is worse than the actual COVID-19 effect.

1. Most of my colleagues are under 70 with good access to healthcare.
2. We sell internationally, and have plants in several locations.
3. Despite this, we are trimming our travel except for "business critical" trips.
4. So far, our raw material supply is OK, and we are able to ship product. How long this condition lasts is anyone's guess, as many strategic minerals come from affected countries.
5. Reduction of air travel has a direct knock-on effect because our metals are critical to air travel. The less air travel, the less demand for our products. This might not have been a problem, since our business has learned from past aviation cycles how to handle these normal variations. However, we are also facing 737 MAX demand headwinds.
6. For high-information/high-skilled white-collar jobs, there is a certain amount of working from home that is possible (and I would argue critical, despite someone else's claim that being able to work from home is tantamount to having a meaningless job). This puts a strain on local merchants, as we aren't going out for lunch, taking clients out to dinner, and similar activities. Other retail merchants will come under more strain as the fear ratchets up, as people will stop shopping at brick-and-mortar establishments.

   Summary - so far, our business has a decent chance of minimal impact from COVID-19 in isolation. However, it may be the final straw, as the saying goes, and in combination with other challenges may have a disproportionate impact.

What is the appropriate policy response?
The low Treasury bond interest rate is screaming for the government to shovel money out the door, both to individuals and to businesses affected by the Coronavirus. Private business will curtail spending, and in such a moment, the government should borrow at exceptionally low rates and do the spending the private sector won't do. Already ex-Goldman Sachs CEO and Trump advisor Gary Cohn is saying the U.S. government is going to have to bail out the airline industry. If the big guys are going to get a bailout, why not the rest of us?

So that's the economic response. Then there's the longer-term restructuring. We should be focused on addressing the following problem, which is that we can't produce enough domestically, especially things we need like medicine. To deal with that, we've been trying to understand why it's so hard to make things in America. This is a tentative unified policy approach to the problem.

How to Make Things in America Again: CLIMB
Why can't we make things in the United States? Well one reason is that American finance and politics is set up to destroy, not build. As just one example of many, a software entrepreneur wrote in Forbes about what happened when he sought financing to grow his healthy business. In talking to hundreds of private equity firms, their basic approach was to offer to invest in order to

generate a quick return. As one put it, *"Man, there's a lot of meat on the bone here!"* The businessman was taken aback at the naked avarice and lack of coherent understanding of what it takes to *build.*[1]

Financiers are a huge problem, but not the only one. I'll put the ingredients for making things in five buckets. I always found acronyms annoying, but they do stick with you. This one is called CLIMB, and it stands for **C**apital, **L**abor, **I**nputs, **M**arkets, and **B**rainpower. That's what a coherent policy response would like if we wanted to make things domestically and make them well.

Capital: Businesses need money to start up, to keep going, and to expand, so running a manufacturing concern requires having a financial system that supports such activity. We do not have such a system right now. Now supposedly, interest rates right now are exceptionally low, so it would seem that it would be easy to get money for profitable ventures. But it's not, because the institutions that can offer capital are looking for either totally safe assets like government bonds or crazy high returns that can only come from grabbing market power or looting.

In other words, monopolies and private equity can borrow money, but people who do useful things that get 6-10% returns have a much harder time doing so.[2] This is largely because small banks have collapsed, and small banks are the networks through which productive enterprises borrow money. According to the Institute for Local Self-Reliance, "In 2018, community-based financial institutions made 52 percent of all small business loans, even though they controlled only 16 percent of banking assets."[3] MIT scholar Suzanne Berger noted that as big bankers buy local banks, local bankers with "intimate understanding of local manufacturing" disappear, making borrowing to make things hard.[4] The government should fix this with a renewed emphasis on small business lending, as Marco Rubio suggests and as has historically been the approach of the Democratic and Republican parties.[5]

Labor: People make things. Workers, skilled labor, managers, and entrepreneurs. Yet as a lot of businesses will tell you, they can't find workers or competent production managers. And this isn't just a function of wages, but the fact that there just aren't the skilled, semi-skilled, and managerial workers in America anymore. Offshoring jobs for decades means that parents tell their kids 'Don't go into skilled manual labor,' and they don't.' This is changing, but this story on the U.S. furniture industry trying to reshore production after decades of layoffs makes the point.

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[1] "Raise Capital Without Selling Your Soul" by Mike Kappel, *Forbes*, March 10, 2020 (link accessed 3/10/2020: https://www.forbes.com/sites/mikekappel/2020/03/09/raise-capital-without-selling-your-soul/#30ca2a8375ed)
[2] "How Monopolies Broke the Federal Reserve," Matt Stoller, *Big,* 8/13/2019 (link accessed 3/10/2020: https://mattstoller.substack.com/p/how-monopolies-broke-the-federal)
[3] "Small Business Lending by Size of Institution, 2018" *Institute for Local Self-Reliance* (link accessed 3/10/2020 https://ilsr.org/small-business-lending-by-size-of-institution-2014/)
[4] Berger, Suzanne. Making in America (The MIT Press) (p. 20). The MIT Press. Kindle Edition.
[5] Congress Responds to the Coronavirus Crisis, *Big,* 3/6/2019, (link accessed 3/10/2020: https://mattstoller.substack.com/p/congress-responds-to-the-coronavirus)

> One answer is the Catawba Valley Furniture Academy here, created by local companies struggling to find skilled employees in partnership with Catawba Valley Community College. Furniture makers are also, for the first time, creating internal training programs and adding benefits such as free health clinics.
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> "My dad has been in furniture his whole life," said Nathaniel Kaylor, a 21-year-old student at the academy. "He told me from the get-go to stay out of it. You get old fast. Go to college."[6]

A real public commitment to fund these kinds of educational institutions, as well as a commitment to putting production *here* is key to ensuring people learn the skills they need to make things. Similarly, in business schools, the people who have executive level experience in production are the losers, the cool kids are the private equity Blackstone alums. This is a huge problem, and business schools need to reorient their focus. That will happen if we eliminate or radically restrict private equity.[7]

***Inputs*:** Building things requires an ecosystem of production so you can find the inputs. For instance, making a sweatshirt requires strings, material, and zippers. All these used to be found in mid-town Manhattan in the 'garment district,' but that ecosystem of inputs is gone. So too across most of our industries, such as electronics. Here's what one electrical engineer told me:

> "NOTHING happens without Chinese suppliers. Circuit boards, parts, housings, packaging, printing. Anyone who says MADE IN USA is... well... let's just call it "stretching the definition". We are SO dependent on China, that I have been studying Mandarin. I have a special book which translates obscure things like "surface mount tantalum capacitor", because guess where the only place in the world is, that they come from?"[8]

Rebuilding an ecosystem of inputs is going to require sustained investment by public entities, as well as aggressive trade rules that prohibit dumping, predatory practices, and private equity looting.

***Markets*:** Starting a business means being able to count on buying in open markets for what you need, and being able to reach customers in open markets for what you sell. Coercion and fraud kill productive activity. Multiple small business owners told me about how hard it is to sell through monopolies at this point. Corporations like Amazon basically take all your margin, and pharmacies are being destroyed by pharmacy benefits managers and drug distributors. Having open markets in which to buy and sell goods is essential if you are going to start a business and succeed. That means reinvigorating antitrust law.

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[6] U.S. Furniture Industry Is Back—but There Aren't Enough Workers by Ruth Simon, *Wall Street Journal,* 12/4/2019 (link accessed 3/10/2020: https://www.wsj.com/articles/the-u-s-furniture-industry-is-backbut-there-arent-enough-workers-11575504528)

[7] Why Private Equity Should Not Exist, *Big,* 7/30/2020 (link accessed 3/10/2020): https://mattstoller.substack.com/p/why-private-equity-should-not-exist

[8] See Appendix

***Brainpower*:** A big part of production is just knowing how to make things, both in terms of academic innovation and production on the line. As one manufacturer told me, "Innovation doesn't just hover above the Great Plains… It is built on steady incremental changes and knowledge learned out of basic manufacturing."[9] This is distinct from labor in that it is about ecosystems of production, like having a well-trained workforce versus having Silicon Valley as an ecosystem of digital technology or 19th century Pittsburgh as an ecosystem of metallurgy. Prior to the 1990s, a lot of knowledge of production in America was held within large vertically integrated large corporations like IBM, Dupont, Boeing and General Electric. The U.S. did a lot of infrastructure investment and procurement, along with antitrust to ensure the decentralization of this capacity. In China and Germany, governments emphasized strong research consortia as well as training regimes and state support. All three of these models ensured that unskilled labor, skilled labor, engineers, and academics could interact in productive ways.

In the U.S., we have gutted our knowledge base for decades, and corrupted our universities. The end of antitrust and the prioritization of private equity led to a large-scale looting of our corporations. Newer Goliaths like Microsoft, Google, Facebook, and Amazon do not generate the public good spinoffs because they do not have to face antitrust scrutiny.[10] Addressing the brainpower problem is similar to the input problem.

So that's the gist of the problem, and the solution. CLIMB. Can we do that? I think so. It will require sustained investment over many years, based on a political consensus that we need to be making things here again. I'm seeing that consensus reemerge, on both the right and the left. The current epidemic is quite scary, but if we want to be a free people, we don't really have much of a choice but to rebuild a political consensus that we have to be able to take care of ourselves and produce what we need.

Letters

Letter #1
In the domestic premium steel/metal producer where I work, the fear is worse than the actual COVID-19 effect.

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[9] "America's Monopoly Crisis Hits The Military," by Matt Stoller and Lucas Kunce, *The American Conservative,* June 27, 2019, (link accessed 3/10/2020: https://www.theamericanconservative.com/articles/americas-monopoly-crisis-hits-the-military/)

[10] See The War within Corporate America, by Matt Stoller, American Affairs, Spring 2020 / Volume IV, Number 1, Testimony of Sally Hubbard Director of Enforcement Strategy Open Markets Institute Before the Senate Judiciary Committee Subcommittee on Antitrust, Competition Policy and Consumer Rights On "Competition in Digital Technology Markets: Examining Self-Preferencing by Digital Platforms" March 10, 2020, "Estates of Mind," by Barry Lynn, July/August 2013, Washington Monthly

5. Reduction of air travel has a direct knock-on effect because our metals are critical to air travel. The less air travel, the less demand for our products. This might not have been a problem, since our business has learned from past aviation cycles how to handle these normal variations. However, we are also facing 737 MAX demand headwinds.
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Letter #2
I'm in lodging, specifically hostelling, where a disproportionate share of the market is international. Two things are killing that market:

1. Trump, as in people hate him and "his" America, and don't want to visit here; and
2. COVID-19 fears and travel restrictions. It's brutal and getting worse. Recessionary spiral would be the optimistic outcome here...

Letter #3
I own a small business (wholesale specialty foods) with three other people. We just had the huge Natural Products Expo in Anaheim cancel at the last minute. Lost a lot of money- I'm sure everyone did. The big players can absorb this but all of us small businesses get hurt.
Hard to say if orders are drying up yet. Seemed very quiet this week though.
And we have a business where you can't really 'work from home'. It's producing, manufacturing, shipping, receiving. (and as a side note- if you can 'work from home' it's probably not really work. See Graeber's Bullsh*t Jobs.) I emailed my Senators (Murray and Cantwell) to tell them they need to get way out in front of this. If this continues like this with closings, social distancing, hoarding, we may be heading toward a Depression. Small businesses will be closing en masse.

Letter #4
I can give you a little supportive history as I lived through the loss of our entrepreneurial culture. In 1970, I bootstrapped the manufacturing company that introduced the first commercial computer display terminal - see https://localwiki.org/ann-arbor/Ann_Arbor_Terminals.

I wrapped that down in the late '80s by choice. In the mid-70s I set up an interactive website (TENonline.org) helping many entrepreneurs around the country bootstrap their own business. I watched that entrepreneurial zeal decay through the '80s & '90s, whereby the early '00s, all I was being asked by US entrepreneurs was "Where do I find venture capital?". Foreigners continued to be active, especially young Chinese entrepreneurs - their interest & enthusiasm took me back to the '70s & made the effort fun again.

This country lost so much during the '80s & '90s. We lost the whole entrepreneurial spirit. During the '70s & early '80s we weren't starting businesses simply to make money. We started them because there was something we wanted to do, to try. Making money was a necessity for us to survive, but we were doing it for the challenge & the fun. The venture capital game is a no-win for the young entrepreneur. Since the VC's first objective is to make money, the first time the founding entrepreneur(s) falters, they're replaced with an established businessperson & relegated to a backroom. They're not given the time or chance to learn to become a good businessperson & all that potential is just thrown out.

The inductive thinkers - the creators - don't have a place in today's industry. A few (like my ex-partner) can make it via the patent route, but that requires the determination, patience & intelligence to learn patent law almost to the equivalent of the attorney, & few meet that bar.

Letter #5
I work at a small US manufacturing company and try, whenever possible, to purchase US made components. I'm seeing a shift where there are two versions of a thing, one is extraordinarily expensive and marketed for Defense or Aerospace while the second version is ridiculously cheap and imported from China. There is no middle ground. Either you are forced to buy the expensive one or you ask, why would I not buy the cheap one? The piece I just purchased was so cheap I couldn't even buy the raw materials to make it myself let alone the labor.

A lot of engine components are like this. There are two tiers of manufacturers, those who can meet the OEM specifications and those who can meet the aftermarket requirements. Difference in price is at least a factor of 10, if not more. But when you can buy an OEM part for $9 or an aftermarket for $0.65 you'd have to think hard on why you wouldn't purchase the cheaper one. Even more glaring is when a corporation has the component made in China but sticks with the $9 price. Then the knockoffs emerge where that same Chinese company counterfeits it, changes the color and label, and sells it for $1 on AliExpress. Then you realize how incredibly bad you're getting screwed by the original designer.

Letter #6
Given the choice I'd prefer to buy industrial components that are fairly priced from a US company but when the price is either Aerospace at $4000 or Chinese at $40, I have to go the Chinese route. I know we once made stuff like this, I still see the old Thomas Register catalogs that list the hundreds of machine shops that made stuff, but most are gone now or consolidated. It's just difficult to see a path where you encourage a US company to get back in the business and not have them screwed by an importer with no skin in the game.

Letter #7
I have spent a lot of time over the years working on preserving manufacturing in the US starting in the late 70s. Even my first job after high school as a machinist and tool and die maker was affected by the changes as my plant moved to Puerto Rico in 1970 for the tax breaks instituted in the late 60s to spur development in Puerto Rico. The US lost a lot of relatively low-end manufacturing as well as some higher end chemical and pharmaceutical manufacturing.

I wanted to respond to your question about why we can't manufacture certain things in the US. Actually, that question misses the problem. We manufacture a great deal in this country. In fact the real value of manufacturing in the US is up substantially about 13% since 2010 (https://apps.bea.gov/iTable/iTable.cfm?ReqID=51&step=1).while full and par-time employment has barely gone up 1%. Employment is down but the value of manufactured goods is way up. The other factor was the dramatic drop in shipping and transportation costs that were accelerated by the OPEC oil crisis in the mid 70s. This led to bigger tankers shipping commodity chemicals and a transformation of chemical production away from local markets so that chemical plants could be located anywhere. This also fed into the containerization of shipping which made it dramatically cheaper to ship small manufactured goods from low cost areas such as China. So, the question is not _why we can't manufacture in this country buy why we don't manufacture certain low complexity things in this country such as face masks and action figures, etc.

Starting in the late 50s and 60s, technology was changing manufacturing dramatically. It accelerated in the 80s with Reagan's tax changes and the "financialization" of the economy. Let me give the example of small action figures which were still made in the US as late as the early 1980s. A company called Strombecker on the west side of Chicago made these toys in a unionized (SEIU) plant that paid roughly minimum wage. The technology (plastic injection molding) was simple. Even with automation labor costs for a $1 toy were a bit less than a penny. In China the costs were far less than 1% of the US labor costs. Financialization of the economy led to Wall Street demands for 40% profit margins (as in the dot com bubble), which low end US manufacturing could not meet. Some businesses which could dramatically automate and boost output could produce sufficient returns (such as for certain plastic gears, etc.) survived and grew though with far fewer and more highly skilled/trained employees. Thus, anything with low per-item costs that did not require labor with advanced manufacturing skills left the US. We maintained a presence in tool and die manufacture for many years and for high end manufacturing (such as large machines costing hundreds of thousands of dollars and where labor costs were not a major factor.).

So, we can and do manufacture many things. Some lower end manufacturing is coming back to the US as we are becoming a relatively low labor cost country in some areas due to lower unionization rates and lower business costs in some regions. Manufacturing face masks is not "profitable" enough nor is it so easy to fully automate the manufacture to make it an "attractive" investment for Wall Street. All of the barriers to manufacturing these items could be addressed by better industrial policy, training and public support for investment but it has not been forthcoming for the last 30+ years.

Letter #8

My small business teaches large enterprises how to act entrepreneurial. It's a bit Quixotic, to be sure, but I think is an inside-the-business way of change that needs to happen in parallel to the government role of incentivizing and regulating change. We run our version of design sprints, internal accelerator programs, and teach new leadership skills specifically around working in a more entrepreneurial way.

We have had 3 gigs cancelled in the last week due to the virus. The market was soft anyway, because big companies are nervous about the economy and all the talk last year of recession.

Ironically, "innovation" is the first budget to get cut. The cancellations are extremely concerning. The good news, I guess, is the budgets will likely still be there when travel is freed up again. Bad news is no revenue and company is already in debt.

The other part of my work is keynote speaking and conferences are also being hit hard and so that side of the business is also soft.

Some of our clients are in manufacturing. There's a small company in Michigan called RJG. Their biggest struggle with manufacturing is lack of talent. Can you believe it? All we've heard about loss of manufacturing jobs and yet part of the problem is a lack of training for people to work in plants. The problem is widely shared among small manufacturers, according to RJG. It's such a problem, in fact, they've launched their own training program. (https://rjginc.com/training/). I am happy to make an intro to them if you or a colleague would find that useful.

Letter #9

I am an electrical engineer, and for the last 10 years I have been consulting on new product design.

NOTHING happens without Chinese suppliers. Circuit boards, parts, housings, packaging, printing. Anyone who says MADE IN USA is... well... let's just call it "stretching the definition". We are SO dependent on China, that I have been studying Mandarin. I have a special book which translates obscure things like "surface mount tantalum capacitor," because guess where the only place in the world is, that they come from?

So, despite many (if not all) of my clients wanting to bring it back home, it just isn't an option this year. Or next.

My little business has at times been quite busy, and I have even employed others here and there. However, I have decided to quit and go find a job at Microsoft or Amazon.

Reason #1? → Health Insurance. The biggest, baddest monopoly of them all, is CRUSHING this country. Mind you, I am of average health, no known issues, and expect to live till I'm 90. But we all know I am just one car accident, or new cancer diagnosis away from bankruptcy. There are exactly zero viable health coverage options for small shops like mine.

Reason #2? → Housing Costs. When I moved to the Seattle area in 1997, I was able to buy a nice 3k sq ft house for $250k. The ex got the house in the divorce, so I have been renting for 9 years. It now costs me $44,400 a year just to cover the rent. Almost 1/5th of what that house cost!!! If I want to buy, I will have to either come up with $1.4M or drive 2 hours a day to work. And of course, hours lost to commuting are a serious opportunity cost to everyone.

After I, and the people I need to run a small business, can afford to simply live... only then we can start to imagine, and create, and spend time on new ventures such as opening a shop, inventing a tool, and enabling local supply chains.

Letter #10
Long time first time. I'm a small board game publisher based out of Dallas, Texas. We produce party games like Two Rooms and a Boom. We mostly fund our projects through Kickstarter, then have the games manufactured in China, and then sell them on Amazon. Six years ago, when we started this made the most sense. Fewest middlemen, biggest profit for me and my partner.

Coronavirus hit our main manufacturer right after Chinese New Year, setting our production schedule back a month or two. Our game has already sold out, so every month lost is a month of sales gone.

Why don't we manufacture in the US? Well we thought about it. Cartamundi, a huge card printer is located in Dallas as well. I spoke to their sales team for a while, the cost to manufacture our flagship game? ~$9. In China? $3.70. Even with freight and shipping we're still around $4.70 per unit. These games sell for $25 MSRP and $12.50 wholesale to retailers. Less then that to distributors. There's no way we could justify a cost of $9 per unit. Even if I could drive to the factory and pick it up and have same day communication.

Now things are changing. With Amazon's stranglehold on the market they're nickel and diming us with fees that effectively make the game as profitable through amazon as it would've been through traditional old school distribution.

On top of that their rules are obscure and obtuse. They change labeling systems and require us to relabel products or pay them to do it. They make us compete with resellers to earn the "buy box" button and the right to sell our own game. We'll need to move to Shopify and build own online storefront to compete.

We hit a turning point when we started manufacturing "zines" for roleplaying games which could be printed digitally in the US and UK for cheap and still give an affordable price point to customers. Hopefully that helps.

The point is though we're going to have to diversify everything. Sales. Manufacturing. Vendors. No one stop shop is safe anymore.

Letter #11
My side hustle/hobby is DJing and producing dance music. One of the things I have been thinking a lot about with the COVID-19 outbreak is how it will impact the live music/performance industry. Ultra, one of the largest US dance music festivals, was cancelled along with France cancelling Tomorrowland. Rumors and petitions are floating around SXSW(which was just confirmed as I type this email) and Coachella may be next. International acts are cancelling tours or live in hotspot countries with their visas on the line (can't 100% confirm this on Twitter yet, but it's being talked about around CRSSD festival here in San Diego this weekend).

One of the legacy fallouts of the digital music movement from the early '00s and on was the near complete loss of income for musicians selling their music via record labels and traditional distribution (side note, I was a co-host of a podcast in 2005/6 about the digital music industry called Fake Science, so I spent a lot of time researching/reporting on this). The last bastion of support is playing/touring but even that is being swallowed up by the labels and other large players.

Now with COVID-19, public fear, government shutdowns of gatherings, etc. I have a lot of concern for professional artists. Specifically, the dance scene. So much of the attendees desire (especially the underground movement) is about experiencing rhythmic patterns on massive, in both size and cost, sound systems. This requires being in a shared place, often packed together in clubs/warehouses. Most people can't or won't be able to replicate this at home, so that option is out.

The concern is starting to percolate in the community but it's more side conversations than outright worry. But, the next few weeks has a chance to really start putting pressure on these events. Look at what happened with the Tool show in New Zealand, and what the fallout will be.

Anyway, I am sure it's on your mind too, I have just been deep diving into the music side, let alone the general bar/restaurant scene, which I am also connected to via a company I founded. That's a whole other correlated topic to deep dive into.

My wife works for a small business here in San Francisco, and today her boss gathered the company and explained how everyone has to now work part time, or there will be significant layoffs because of the Coronavirus. The company has existed as a part of the Japanese tourism industry for the past 46 years. When Japanese people book tours to San Francisco, my wife's company does on-the-ground logistics such as providing Japanese-speaking drivers, tour guides, restaurant and hotel bookings, etc. These services are somewhat white-labeled, they work with tour groups from a variety of Japanese travel agencies.

With Coronavirus cases now being reported in and around the Bay Area, almost all tours have been cancelled. My wife says there's nothing to do at the office. The company seems to mostly be run for the benefit of those working in it rather than profit, the boss has shown a great reluctance to put any of the aging staff out of a job. Now they can't keep going, and so today laid off a couple of the most problematic workers and everybody else is now part-time. The owner is comparing this when he cancelled the office lease and almost shuttered the company back when 9/11 happened.

On a more positive note, I work for a 3D Printer startup. The industry of 3D printing is still in its infancy, but it's getting a lot of attention from large manufacturers, as a way to move production closer to home. With our 3D printers, one of our customers can print molds in their factory overnight, rather than ordering them milled in China and shipped, requiring 3 months lead time.

Letter #12
I operate a small pharmacy in Salt Lake City, UT. The pharmacy industry, as you are aware, is immensely concentrated and has substantial pressures that make it very difficult to build out a local supply chain. In case you need the background of this concentration, I will describe it here.

1) Pharmacy sales pricing is almost entirely set by monopsonist pharmacy benefits managers. The largest three PBMs, OptumRx, CVS/Caremark, and Express Scripts, Inc control the pharmacy reimbursements for something like 80% of all 3.4 billion prescriptions filled annually in the United States. Starting April 1, Express Scripts will process prescriptions on behalf of the #4 PBM, Prime Therapeutics. PBMs generally reimburse pharmacies for branded medications at a discount off of the "list price" of medications, known as the AWP. This discount contractually grows by about 0.5-1% annually and is today at the point of approximately reimbursing small pharmacies like ours at cost for medications.

   Next year, most small pharmacies will be reimbursed below cost on all branded medications. This makes the generics business all important to the survival of small business pharmacies. PBMs reimburse pharmacies for generic medications based on "lesser of" logic, meaning that they will pay the pharmacy the lowest of three prices a) the pharmacy's submitted charge b) a contractual discount off of AWP or c) the PBM's proprietary "Maximum Allowable Cost" (MAC) for that medication, which is theoretically based on a survey of market prices for a given medication. Something like 90% of generics are paid under MAC terms. Under the terms of a PBM-pharmacy contract, the PBM can change the MAC at any time with no notice. For example, Aetna's Medicare Part D plan has reduced their MAC prices across our book of business by ~$25/prescription. As our acquisition costs have remained approximately the same, this means our margins have dropped by $25/rx on that contract, from $28/rx to $3/rx. This is unsustainable. There is a theoretical recourse in the form of a "MAC appeal," but these are routinely denied stating that the reimbursement was according to contract.

   This pricing logic puts substantial pricing pressure on the pharmacy, and in essence means that regardless of consumer or pharmacist preference, the PBM will reimburse the pharmacy based on the price of the lowest priced generic medicine available in the market. If I or my patients desire to source medications from American or European companies rather than Indian or Chinese companies, I do so out of my own pocket, not my customer's pocket. This is beneficial to end payers (employers and state medicaid programs, mainly) because they spend less than they otherwise would, but it comes at the expense of an extremely brittle supply chain.

2) Pharmacies like ours generally do not purchase medications direct from the manufacturers anymore. We generally purchase them from a pharmaceutical wholesaler, including McKesson, Cardinal Health, AmeriSource Bergen Company and several smaller players. These top three wholesale something like 80-90% of the prescriptions dispensed in the country, and so have enormous market power both with the pharmacies and with the manufacturers.

   In a related line of business, Cardinal Health is the primary wholesaler for approximately 90% of all hospitals in the US, once again leading to a brittle supply chain. An example of the market power of the major wholesalers is attached - McKesson has a prime vendor agreement with a pharmacy in which if the pharmacy purchases at least 85% of all of their generics from McKesson, the pharmacy will receive a "rebate" of 35% of the invoiced price. However, McKesson ALSO operates a "secondary wholesaler" called Master's, in which it tries to carve out additional sales from pharmacies who use another prime vendor. A pharmacist/owner friend of mine who uses McKesson as her prime vendor recently noted that the invoice pricing at Master's was substantially lower than the post 35% rebate prices she was receiving via her Prime Vendor Agreement. When she pointed this out to McKesson, they responded by increasing HER prices at Master's to match the invoice prices at McKesson. See attached photo in which the Master's invoice is marked up with the post-rebate PVA Mckesson price in purple). Each of these major wholesalers plays a similar game - Cardinal has ParMed and ABC has SmartSource. In essence they have two price structures - a competitive price and a locked in customer price. In a marketplace without market power, I don't believe that this scenario would happen.

3) The wholesalers and major pharmacy chains/PBMs operate incredibly large generics purchasing consortia. For example, Red Oak Sourcing is a 50/50 joint venture between Cardinal Health and CVS/Health, and purchases something approaching 30% of all generic medications produced worldwide. That is incredibly consequential for the ability of US-based start up manufacturers to compete in the marketplace - if you can't get to the pricing desired by Red Oak (and the other consortia), you essentially can't gain access to the marketplace at all. Other major generics consortia include EconDisc Sourcing (a division of ExpressScripts), ClarusOne sourcing (joint venture of McKesson and Walmart), and Walgreens Boots Alliance Distribution (WBAD, a division of Walgreens). I believe that these 4 consortia purchase something approaching 85% of total GLOBAL volumes of generic medication.

4) Vertical integration - note also that there is increasing vertical integration across lines of business for the entire pharmacy marketplace - PBMs now operate pharmacies (CVS/Caremark being the most obvious), steer high dollar prescriptions to subsidiary mail order pharmacies, and own their former customers, insurers (CVS/Aetna, ESI/Cigna and OptumRx/United being obvious examples). Also due to this vertical integration, Insurers/PBMs are able to pay their subsidiaries a massive markup over what they pay their competitors (if you're interested I can provide numerous examples).

I believe that a strong antitrust regime could dramatically change this picture by breaking up these vertically and horizontally integrated monstrosities and restoring some semblance of fairness for both small pharmacies, small wholesaler, and small manufacturers here in the US.

Letter #13
I work in music licensing/ publishing. My Canadian colleagues have access to a number of provincial grants. Some are even able to tap into substantial lines of credit through the government of Montreal so they can offer advances and hire people.

Americans in the arts, of course, have no such option. There are a lot of factors driving for industry concentration but lack of access to capital for small labels and publishers definitely isn't helping.

1. SXSW was cancelled. It's difficult to put a price on its cancellation - it helps me build new relationships and strengthen existing ones and is tough to quantify, but it's definitely a huge deal in my industry.
2. Lack of access to capital. If you are a small business or want to start a business, accessing capital is a problem if you don't come from generational wealth.