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America's small businesses: Time to think big

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October 2024

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At a glance

— **Micro-, small, and medium-size enterprises (MSMEs) are the bedrock of the US economy.** They employ nearly six in ten workers, produce almost 40 percent of value added nationally, and grow into a meaningful share of very large corporations.

— **MSMEs in the United States are only half as productive as large companies, compared with 60 percent in other advanced economies.** Narrowing the productivity gap, which is equivalent to 5.4 percent of the US GDP, is particularly vital in an era of shifting global production.

— **MSME performance varies across US states and metro areas.** Some of the variation is due to sector mix, but overall, the performance of large and small businesses tends to go hand in hand, as local variations influence the productivity of all businesses, regardless of size.

— **Interactions between small and large businesses are key to boosting collective productivity.** Strengthening networks and collaboration with large companies—in supply chains, industry clusters, and customer–provider interactions—could help US MSMEs gain advantages of scale in technology, human capital, market access, and finance.

Introduction

California's Napa Valley wine industry is world-renowned, generating $50 billion annually in economic impact.[1] The wines produced among the 700 wineries in the region rival those of any other region across the globe.

The story of the Napa wine industry is a familiar one. Only a few decades ago, the region was a rural outpost with a small community of mostly independent vineyards. It boomed after investors and entrepreneurs worked together, put their product to the test, and won awards against the world's best in the 1970s.

Napa is just one example of places and industries springing up from humble beginnings to become global successes. Dalton, Georgia, is considered a global carpet capital.[2] Eighty-five percent of the carpets sold in the United States and 45 percent sold globally are made in the region. Similarly, High Point, North Carolina, is a global hub for furniture—at one point the region was responsible for producing 60 percent of all furniture sold in the United States.[3] Its biannual markets host exhibitors from around the world.

Today, Napa wineries, Dalton carpet companies, and High Point furniture factories are a mix of big and small businesses, and in many cases still include family-run operations. They succeeded not only because of their product but also because of their ability to efficiently produce it at scale. The regions' success illustrates how, under the right conditions, micro-, small, and medium-size enterprises (MSMEs) in any industry can expand their global reach.

To get there, US MSMEs should look to ramping up productivity, a move that will be vital to American competitiveness in the coming years (see sidebar "Measuring productivity"). Small businesses can reach the next level of growth by taking advantage of new technology, including generative AI (gen AI), and partnering with bigger companies, and they will need the infrastructure and systems to support them.

Measuring productivity

Productivity is a measure of how efficiently goods and services, or output, are produced, compared with the amount of inputs used.[1] In macroeconomic terms, it is defined as the value of the goods and services produced, divided by the amount of labor, capital, and other resources required for its production. For this report, we focus on labor productivity, measured as value added per worker (in US dollars at purchasing-power parity). The more accurate measure of labor productivity is value added per hour worked—as the number of weekly hours worked varies substantially among US states. For example, the average weekly hours worked by production employees on manufacturing payrolls in the United States varied from 27.7 hours in Alaska to 44.3 hours in Louisiana in 2023.[2] We use the per-worker metric, as it is more commonly available across size categories and sectors. Due to the lack of comprehensive data at the individual company level for micro-, small, and medium-size enterprises, we rely on subsector-level average productivity to make inferences.[3]

1 "Investing in productivity growth," McKinsey Global Institute, March 27, 2024.
2 "State and metro area employment, hours, & earnings," US Bureau of Labor Statistics, April 2023.
3 We focus on national- or sector-level productivity from a growth economics perspective. Organizational-productivity research often studies issues related to attrition, disengagement, skills mismatch, or time inefficiency. See, for example, Aaron De Smet, Marino Mugayar-Baldocchi, Angelika Reich, and Bill Schaninger, "Some employees are destroying value. Others are building it. Do you know the difference?," *McKinsey Quarterly*, September 11, 2023.

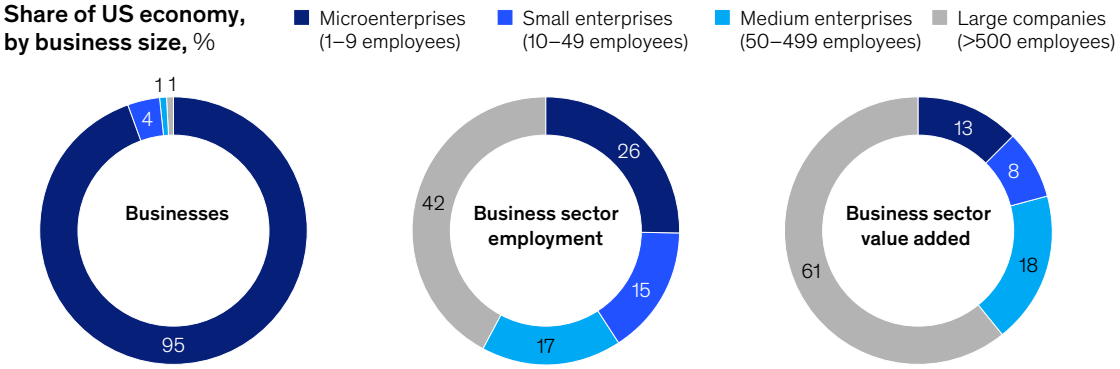
1. Small businesses are the bedrock of the US economy

The McKinsey Global Institute aggregated a richly granular data set of MSMEs and large companies across 12 broad sectors, 68 level-two subsectors, and more than 200 level-three subsectors in 16 countries with different income levels, accounting for more than 50 percent of global GDP. In this group (listed by per capita GDP in 2021 in purchasing-power-parity terms) are ten advanced economies (the United States, Germany, Australia, the United Kingdom, Italy, Israel, Japan, Spain, Poland, and Portugal) and six emerging economies. MSMEs play a large role across the board—in the advanced economies, they average 66 percent of employment and 54 percent of value added.

The United States has an ample small business engine. MSMEs, defined as businesses employing up to 500 people, are a major foundation of economic activity, responsible for 58 percent of jobs and 39 percent of value added in the business economy (Exhibit 1).

Exhibit 1

Micro-, small, and medium-size enterprises are the backbone of the US economy.



Note: Year for which data are available is 2017. Micro-, small, and medium-size enterprises are those with fewer than 500 employees. Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households, and activities of extraterrestrial organizations.
Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business*, US Bureau of Economic Analysis; McKinsey Global Institute analysis

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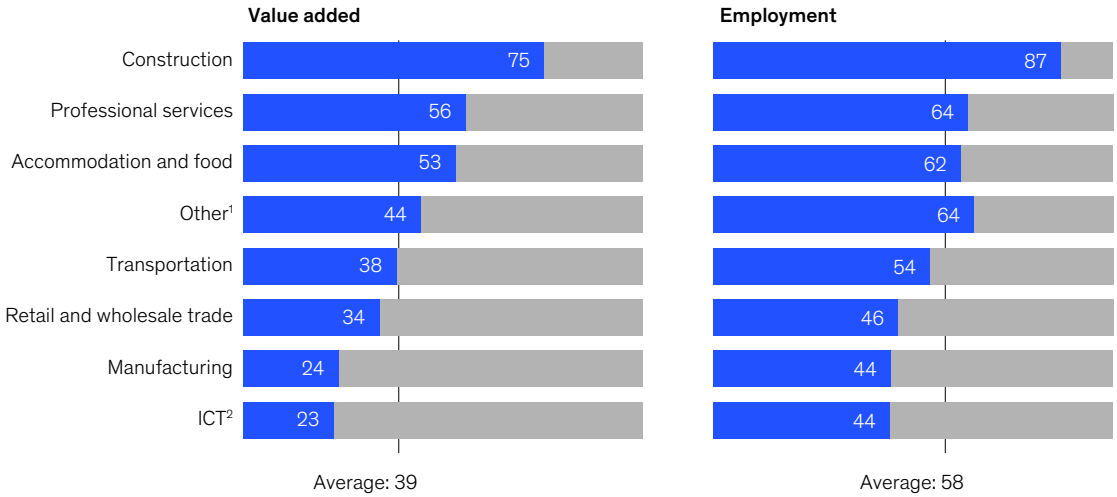
In some US business sectors, MSMEs have an outsize impact. They account for more than three-fourths of workers and value added in the construction sector, for example. And they account for more than half of all workers and value added in the professional services and accommodation and food sectors (Exhibit 2).

MSMEs also help fuel the US economic engine. Companies that were MSMEs at some point since 2000 now represent 17 percent of publicly traded companies valued at $10 billion or more as of 2023 (Exhibit 3). Small technology companies have made the biggest breakthroughs—nearly a quarter of large public tech companies were MSMEs in the past 25 years, Meta and Zoom Video Communications among them. Many of today's big manufacturing companies also started as small factories. Monster Beverage and Tesla are recent examples. Innovation has been a big factor in fast-scaling companies. Small companies in the tech sector have produced more patents per employee than their bigger competitors.[4]

Exhibit 2

US micro-, small, and medium-size enterprises play a sizable role in construction, professional services, and accommodation and food sectors.

Micro, small, and medium enterprises' share of contribution in US businesses, %



Note: Year for which data are available is 2017. Micro-, small, and medium-size enterprises are those with fewer than 500 employees. Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households, and activities of extraterrestrial organizations.
[1]"Other" includes mining, utilities, administrative and support services, other service activities.
[2]Information, communication, and technology.
Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business*, US Bureau of Economic Analysis; McKinsey Global Institute analysis

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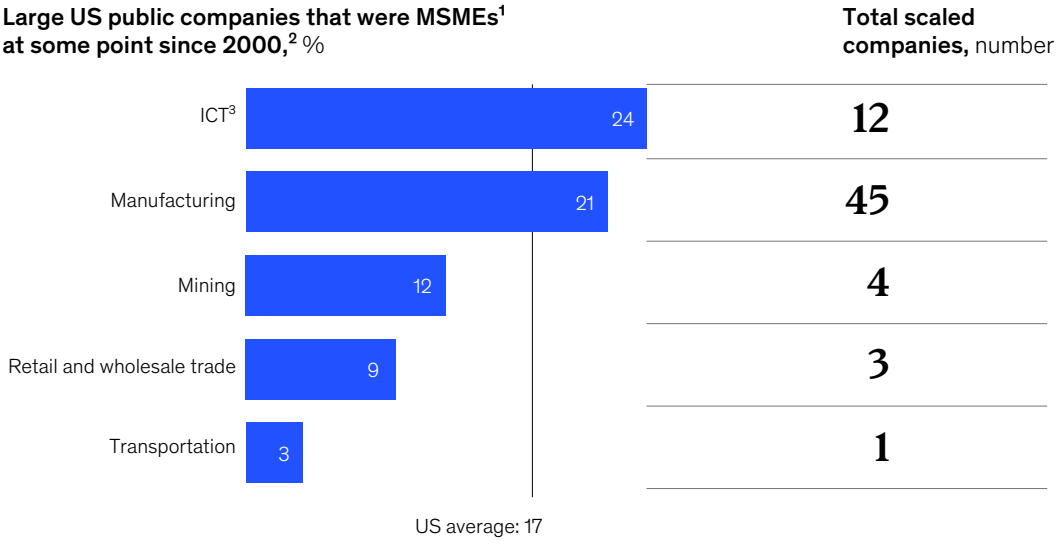
Exhibit 3

Small firms contribute to dynamism.



Note: Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households and activities of extraterrestrial organizations. Four other sectors were excluded from this analysis due to limited availability of company-level data: accommodation and food services, professional services, administrative services, and other personal services.
[1]Micro-, small, and medium-size enterprises.
[2]Share of large public companies in 2022 that were MSMEs at some point since 2000. Large companies defined as public companies with market capitalization >$10 billion (as of Dec 2022); number of large companies = 403, of which 67 were MSMEs at some point since 2000. The listed sectors include 361 large companies, of which 65 were MSMEs at some point since 2000.
[3]Information, communication, and technology.
Source: S&P Capital IQ; McKinsey Global Institute analysis

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2. US small businesses struggle with productivity

The United States enjoys a status as a global leader in business, with 621 of the 2,000 largest global publicly traded companies, according to Forbes, and is home to a disproportionately high number of very large, highly productive companies or superstars.[5]

However, when it comes to small business productivity on a global scale, US MSMEs are comparatively average. US small businesses, in purchasing-power-parity terms, are roughly on par with those in the United Kingdom, Japan, Germany, and Italy. Among the ten advanced economies we studied, small companies are, on average, 60 percent as productive as big businesses—but US small companies are just 47 percent as productive (Exhibit 4).

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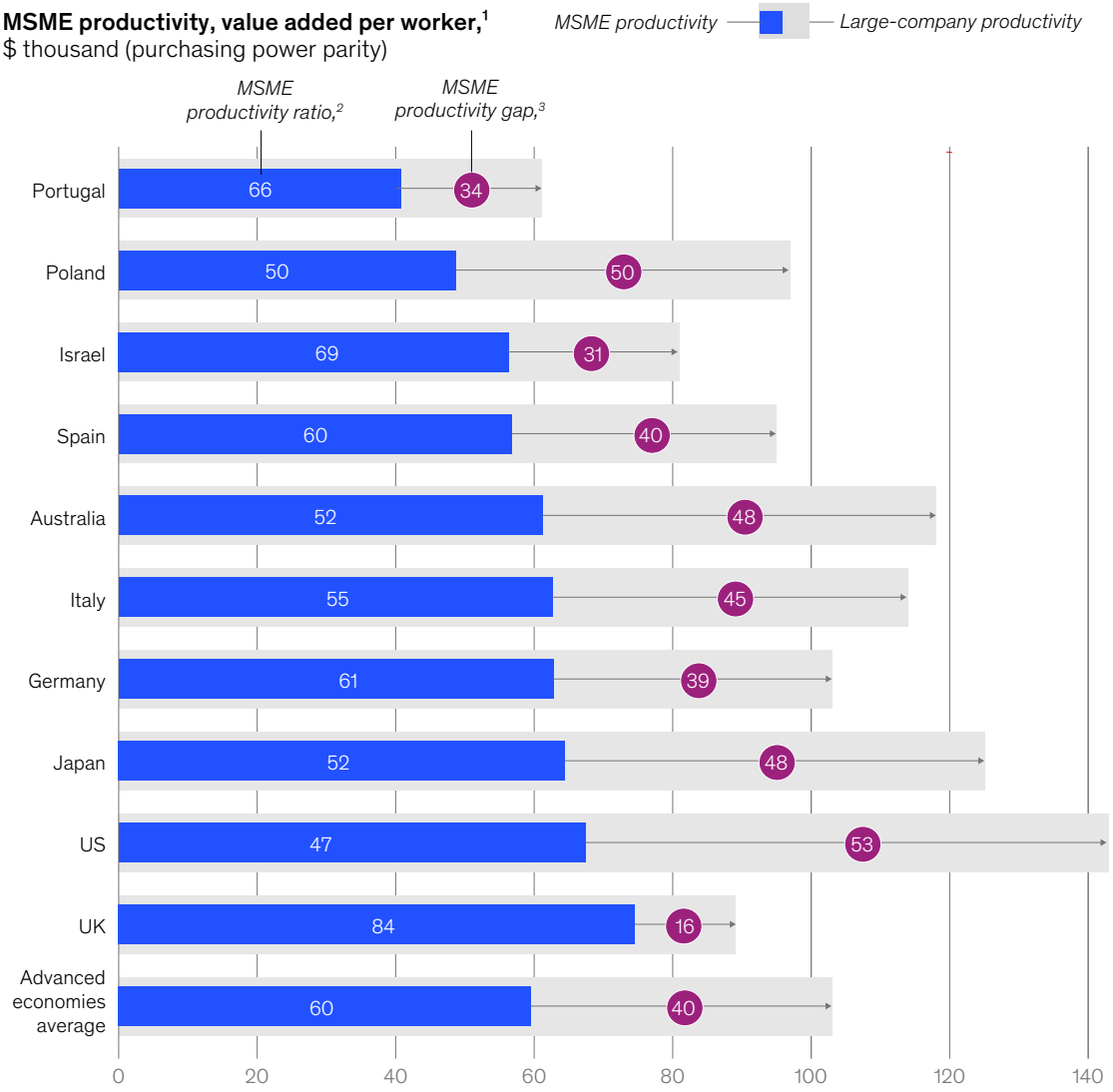
Exhibit 4

US micro-, small, and medium-size enterprises are only half as productive as large firms—a wider gap than in other advanced economies.

MSME productivity, value added per worker,[1]
$ thousand (purchasing power parity)



Note: Micro-, small, and medium-size enterprises (MSMEs) are those with fewer than 500 employees. Analysis excludes the following sectors across all countries due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households and activities of extraterrestrial organizations. Analysis also excludes additional sectors varying by country because data are not available, namely other service activities in Italy and Portugal.
[1]Year for which data are available and represented varies by country from 2016 to 2019; MSME and large category definitions match each country's national definition.
[2]Defined as ratio of MSME productivity to large-company productivity.
[3]Measured as 1 minus MSME productivity ratio.
Source: Country-level economic and business censuses; Eurostat; International Labor Organization Department of Statistics; labor surveys; MSME surveys; OECD; S&P Global Market Intelligence; McKinsey Global Institute analysis

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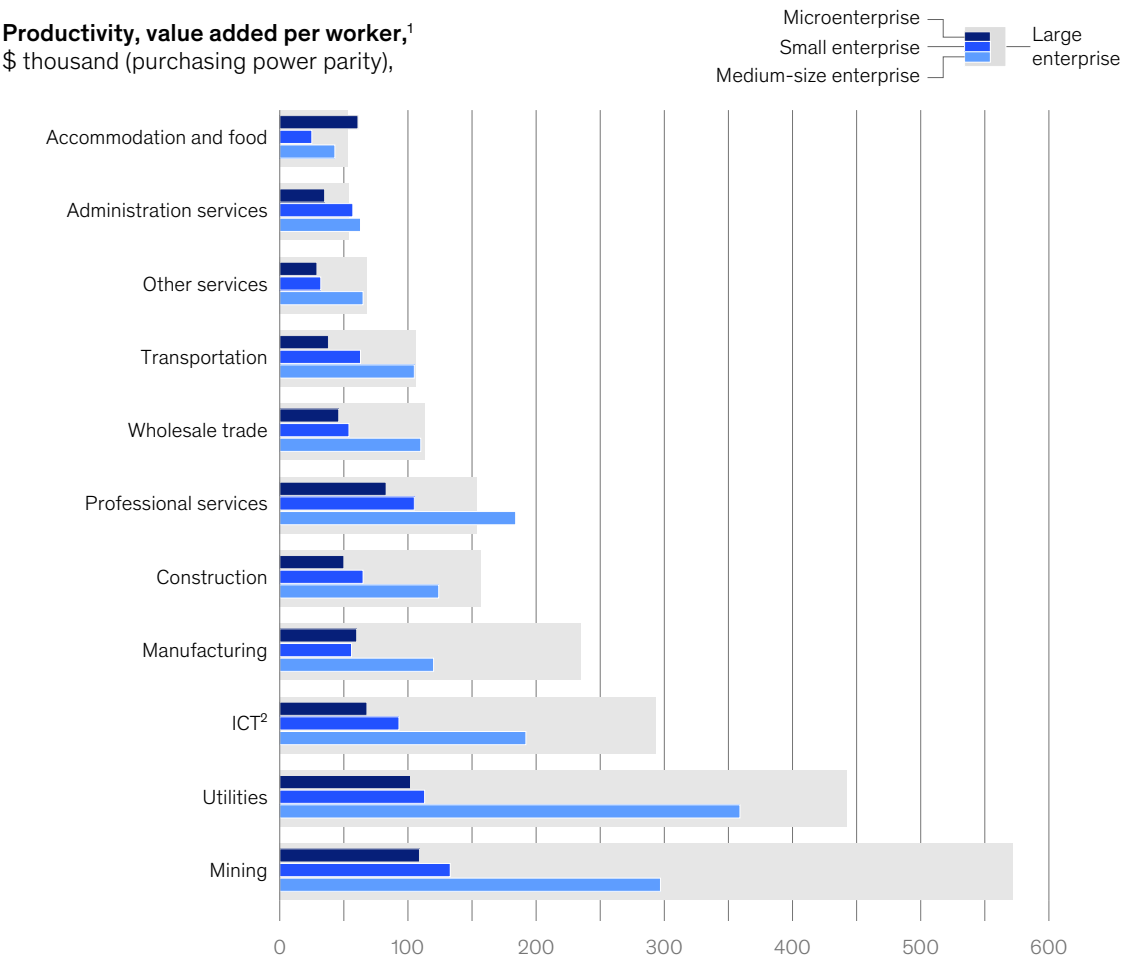
Small business productivity varies by sector. While, on average, US MSMEs are on par with those in the United Kingdom, Japan, Germany, and Italy, they lag in a few sectors—mining, transportation and storage, and administrative services. Additionally, they trail in some technology subsectors such as computer programming and some manufacturing subsectors such as basic metals, machinery and equipment, and furniture.

The productivity ratio relative to large companies also varies by sector. In the United States, it ranges from 35 percent in mining to 88 percent in the administrative-services sector (Exhibit 5). In other words, MSMEs in the mining sector face the widest gap in productivity relative to their large peers in the same sector, closely followed by information and communications technology (ICT) and manufacturing. On the other end, MSMEs in administrative services come closest to performing as productively as their large peers.

Exhibit 5

US micro-, small, and medium-size enterprise productivity levels vary across sectors and size categories relative to large firms.



Note: Micro-, small, and medium-size enterprises (MSMEs) are those with fewer than 500 employees. Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households, and activities of extraterrestrial organizations.
[1]Ordered by overall MSME productivity. Year for which data are available/represented varies from 2016 to 2019.
[2]Information, communication, and technology.
Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business*, US Bureau of Economic Analysis; McKinsey Global Institute analysis

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The MSME productivity ratio tends to be lower and the productivity gap wider in sectors where competencies such as technology, human capital, market access, and finance play a significant role in driving business competitiveness.

In fact, in a few sectors—administrative services, professional services, transportation and storage, and retail and wholesale trade—medium-size businesses with 50 to 499 employees perform at the same level or even better than large companies (with more than 500 employees).

But, apart from accommodation and food, microenterprises with ten employees or less and small enterprises with ten to 49 employees are less productive than medium-size enterprises, which are on average twice as productive. Overall, the gap widens as the company size gets smaller.

The vast productivity gap can be partially explained by differences in the kind of work undertaken by small and large businesses. Small businesses play a crucial role in enabling the productivity of large companies, which tend to focus on core competencies and outsource less essential activities to other businesses, a phenomenon called work fissuring.[6] This results in greater concentration of higher-value-added activities in large companies, with smaller businesses taking on lower-value work.

But ultimately, the productivity ratio depends on advantages of scale in areas such as technology, human capital, market access, and finance. MSMEs struggle to access these competencies at the same level as larger companies. For example, the share of MSMEs that adopt technologies such as customer relationship management systems and artificial intelligence is only half the share of large companies.[7] Large companies are twice as likely to provide formal skilling programs and are more active in monitoring performance and awarding performance bonuses.[8] MSMEs derive just 5 percent of their total sales from direct exports, which is one-third of the sales made overseas by large enterprises. The share of large businesses using banks for working capital financing is 1.5 times that of small businesses. Consequently, the MSME productivity ratio tends to be lower and the productivity gap wider in sectors where these competencies play a significant role in driving business competitiveness.

3. Small business economic impact and productivity varies by region

MSMEs are ubiquitous across all states, but their economic contribution is uneven. On one end are states such as Nevada and South Carolina, where small businesses employ around half the workers and represent about 35 percent of receipts in the business economy. On the other end, in states such as Montana and Vermont, about three-fourths of employment is in small businesses, generating about 55 percent of those states' receipts (see sidebar "How small businesses fared during the COVID-19 pandemic").

Among the top 40 metropolitan statistical areas (MSA) by employment, small businesses account for between 25 and 50 percent of receipts and between 50 and 70 percent of employment in the business sector (Exhibit 6).

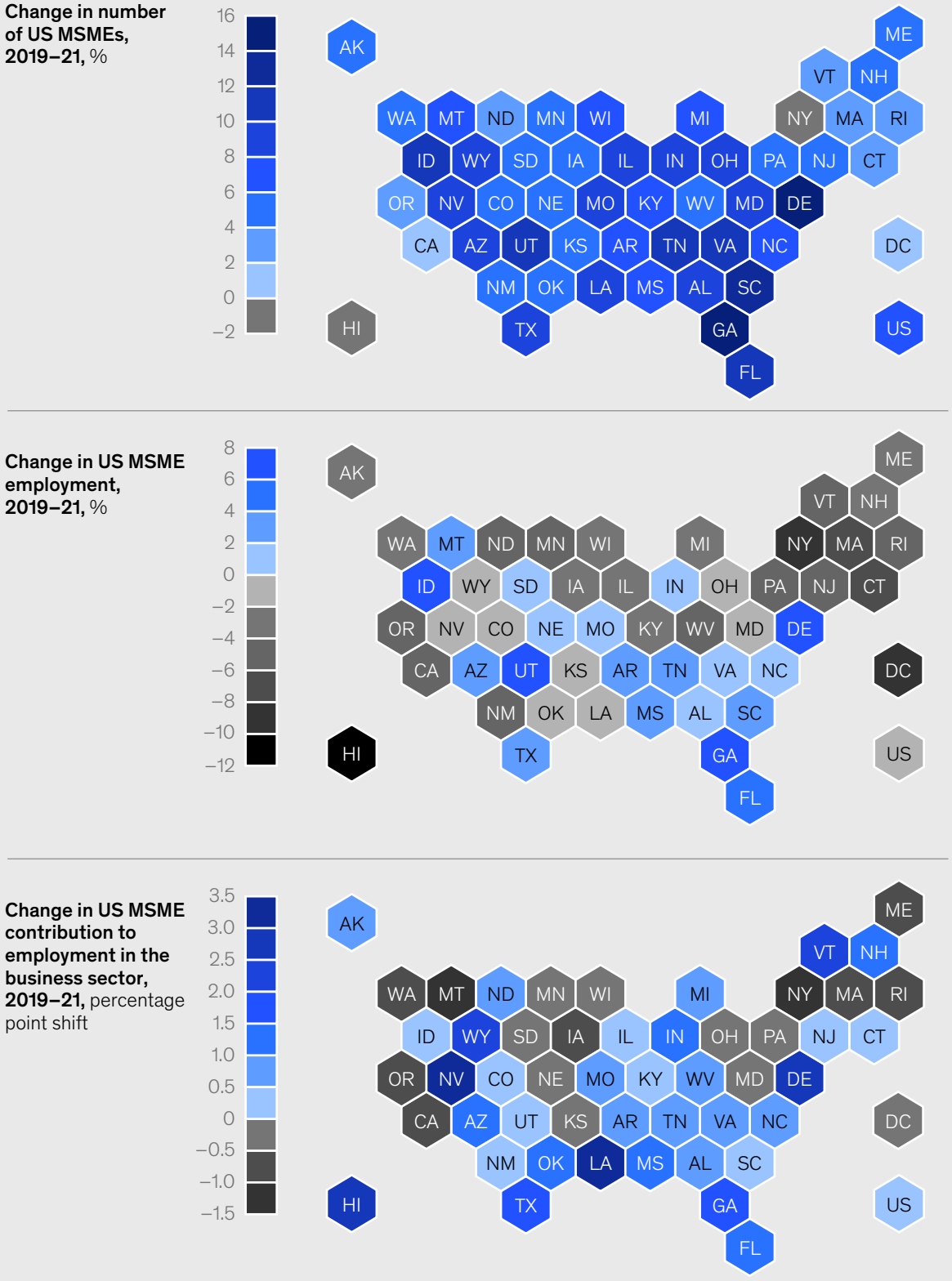
How small businesses fared during the COVID-19 pandemic

The number of new businesses registered each year in the United States increased dramatically during the pandemic. Over 2019 to 2021, the number of new businesses registered increased by 54 percent. However, while new businesses were registered, existing businesses closed—and their numbers appear to be in balance. The net number of micro-, small, and medium-size enterprises (MSMEs) increased by only 6 percent between 2019 and 2021 (exhibit). On the other hand, despite the number of new business registrations growing only by 10 percent in the prepandemic period from 2017 to 2019, the net number of MSMEs grew by 4 percent, and their employment also increased by 3 percent. A relatively higher number of MSMEs appear to have survived during this period.

Despite the significant increase in new business registrations during the pandemic, these businesses did not generate proportionate employment, with the net workforce in MSMEs falling in half the states over 2019 to 2021. On average, the number of MSME workers fell by 1 percent in the United States. The proportion of workers employed by MSMEs stayed stagnant for the most part. This suggests that the industry structure might be gradually changing, with some small businesses growing into large companies, or more employees moving from smaller to larger companies, transitioning to more productive work. Overall, this is the right direction of movement for the United States.

Exhibit

While the number of micro-, small, and medium-size enterprise companies grew quickly from 2019 to 2021, their employment rates remained flat.



Note: Year for which data are available is 2017. Micro-, small, and medium-size enterprises (MSMEs) are those with fewer than 500 employees. Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households, and activities of extraterrestrial organizations.
Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business*, US Bureau of Economic Analysis; McKinsey Global Institute analysis

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The contributions of MSMEs to employment and business revenue varies widely. Among states, the biggest contributions are in the US Northeast and the lower contributions are in the South.

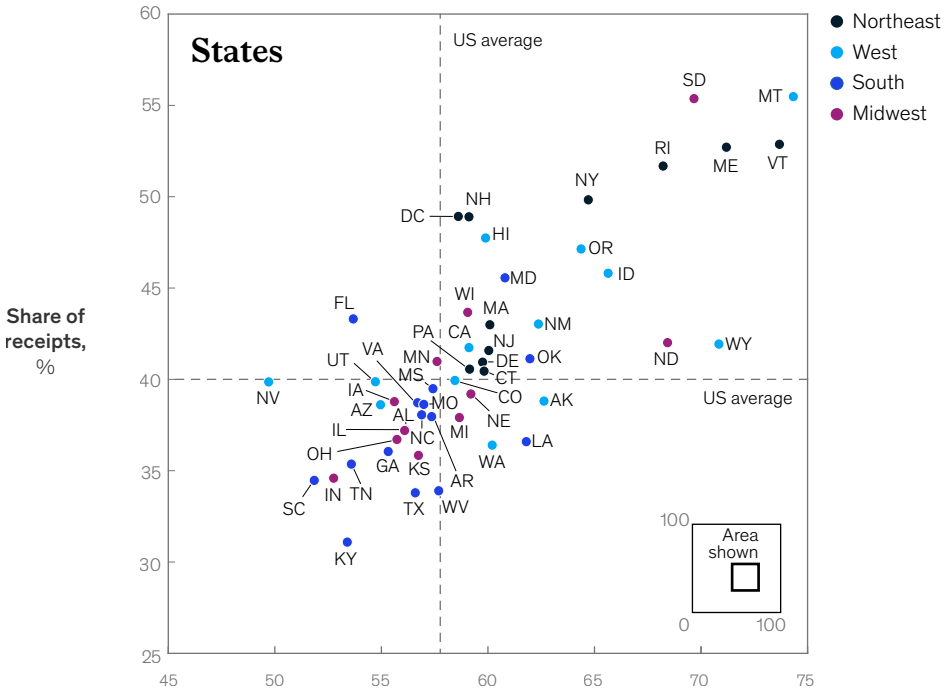
Among the top 40 US MSAs, the contribution of employment and revenue varies even more than among states, but there is no concentration by region or state. New York and Miami are outliers where MSMEs play a bigger role in the economy.

The contributions of MSMEs to employment and business revenue varies widely. Among states, the biggest contributions are in the US Northeast and the lower contributions are in the South.

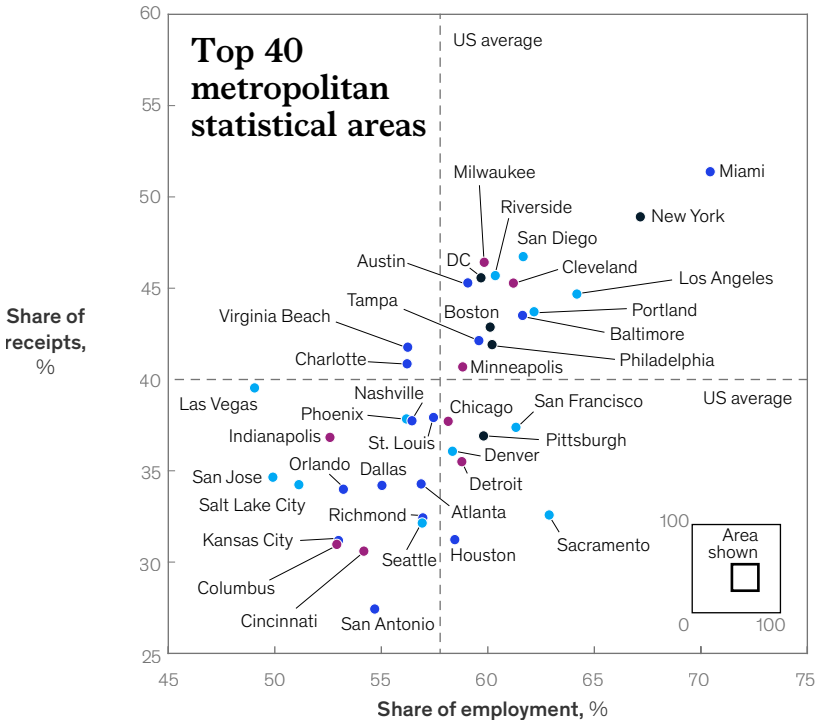
Exhibit 6

Micro-, small, and medium-size enterprises play a sizable role across all US states and metropolitan statistical areas, but with variation.

MSME business sector receipts and employment, by region



MSME business sector receipts and employment, by region



Note: Year for which data are available is 2017. Micro-, small, and medium-size enterprises (MSMEs) are those with fewer than 500 employees. Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households, and activities of extraterrestrial organizations.
Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business*, US Bureau of Economic Analysis; McKinsey Global Institute analysis

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This variation in the economic contribution of MSMEs across states and MSAs is also reflected in their performance, measured as receipts per worker as a proxy for productivity. Some of these differences could be attributable to differences in price levels across states. Clearly, states with higher prices might generate higher receipts per worker than states with lower prices, independent of any true differences in performance. So to compare the true performance of MSMEs across regions, we measured the receipts that MSMEs generate for every worker in each state and in the top 40 MSAs by employment, adjusted for regional price parity.[9] Across sectors, MSMEs are assumed to generate revenue locally within the state, while large companies are assumed to generate revenue globally, nationally, or regionally.[10]

MSME performance varies significantly across states (Exhibit 7) and MSAs (Exhibit 8). Their performance goes hand in hand with large-company performance. In general, where large companies perform better or poorer than the national average, so do MSMEs, and vice versa.

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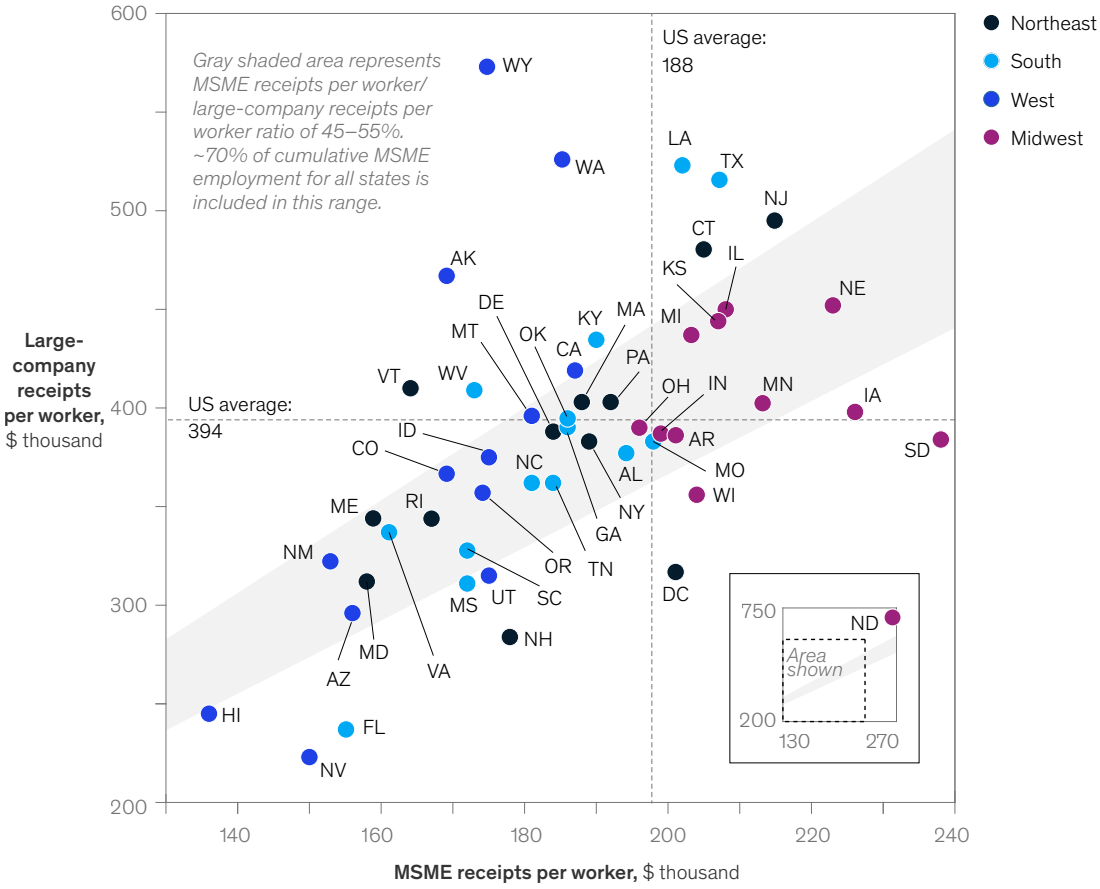
Exhibit 7

Across states, MSMEs and large-company receipts per worker go hand in hand.

Micro-, small, and medium-size enterprises (MSMEs) and large-company performance, by region



Note: MSMEs are assumed to generate revenue locally within the state, while large companies are assumed to generate revenue globally, nationally, or regionally. As a result, to enable comparisons across states, we adjusted MSME receipts per worker based on regional price parities within the state, but did not adjust large company receipts. We adjusted for all sectors. This approach has drawbacks for MSME receipts per worker in sectors such as mining, manufacturing, and information, communication, and technology, wherein a sizable share of MSME revenue generation might be nonlocal. We estimate that this limitation could imply ~10–15% variation around the mean. Similar limitations apply to large companies that might primarily generate receipts locally in certain sectors, such as a large restaurant chain only operating in a few states. Year for which data are available is 2017. MSMEs are enterprises with fewer than 500 employees. Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households, and activities of extraterrestrial organizations.
Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business* and "Regional price parities by state and metro area," US Bureau of Economic Analysis; McKinsey Global Institute analysis

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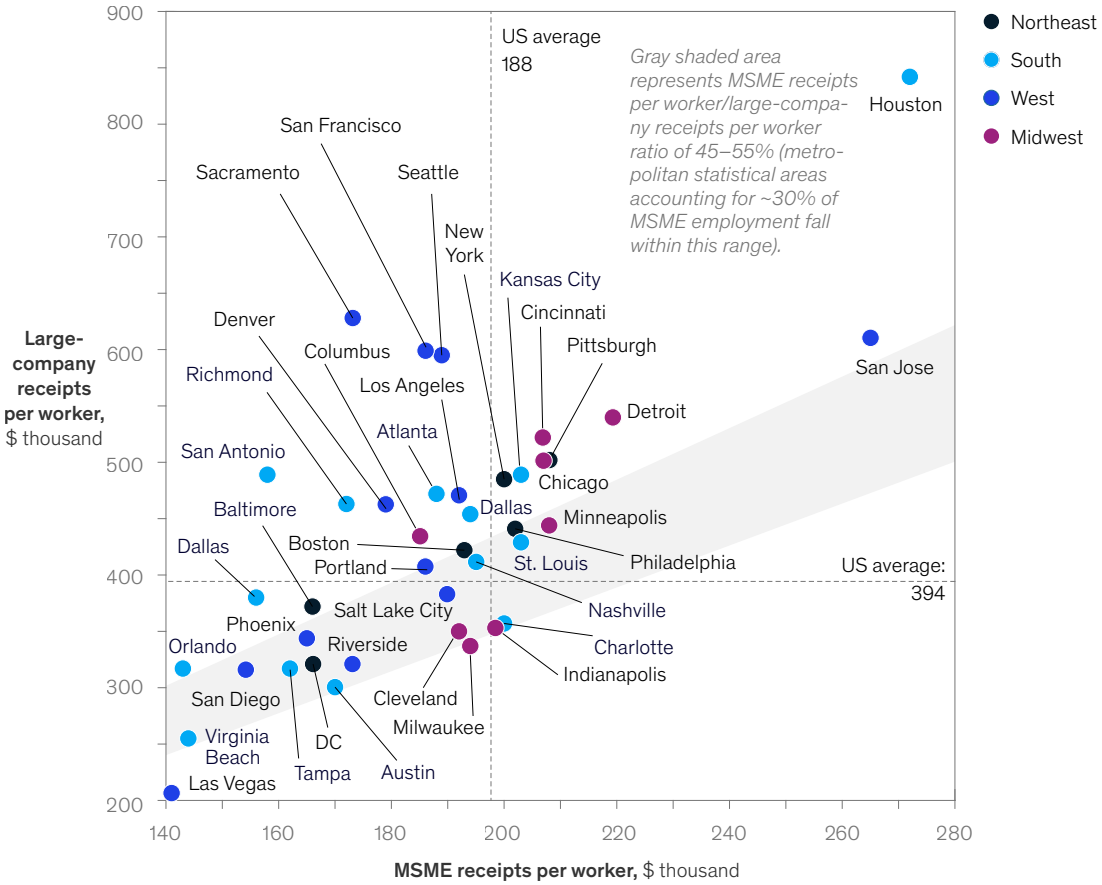
MSME performance relative to large companies is concentrated within a narrow band. In more than 30 states with 70 percent of all MSME employees, small business receipts per worker are 45 to 55 percent that of large businesses. However, among the top 40 MSAs, there is a larger variation. The same relative performance band of 45 to 55 percent comprises only 15 MSAs, accounting for only 30 percent of employment.

So why do MSMEs in some states and metros perform better than others? Reasons could include differences in the business environment and policies. Some states have tax, regulations, and compliance systems that support the expansion of large and small companies alike. Some states have more deeply ingrained business networks, greater availability of financing, and a concentration of talent, which provide a boost to MSMEs that struggle to access these competencies.

Exhibit 8

Across metro statistical areas, micro-, small, and medium-size enterprises and large-company receipts per worker go hand in hand, but with greater variation.

Micro-, small, and medium-size enterprises (MSME) and large-company performance, by region



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Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business* and "Regional price parities by state and metro area," US Bureau of Economic Analysis; McKinsey Global Institute analysis

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4. More productive small businesses will boost US competitiveness

Capturing the MSME productivity potential is vital for US competitiveness amid a changing world: geopolitical shifts, net-zero transitions and the rise of the green economy, and greater healthcare needs for an aging population, along with the developments in gen AI (see sidebar "How generative AI can propel small businesses").

Although conditions vary across states and MSAs, the low productivity levels of small businesses are holding back US competitiveness. Narrowing the MSME productivity gap is equivalent to 5.4 percent of GDP (Exhibit 9).[11]

Narrowing the MSME productivity gap is equivalent to 5.4 percent of GDP.

How generative AI can propel small businesses

There is already a tech adoption divide between large and small businesses. The share of micro-, small, and medium-size enterprises (MSMEs) that adopt technologies such as customer relationship management systems and artificial intelligence is only half the share of large companies.

However, there is scope for democratization of tech access with recent AI developments—much of the new software targeted at small businesses is expected to have AI, and even generative AI (gen AI), embedded in them. Such gen-AI-enabled products and services can be used with natural-language prompts, rather than advanced IT skills.

This democratization makes AI more accessible to small businesses, but also raises the cost of nonadoption. It can potentially create a divide between small businesses that embrace technology and those that don't. For example, if previously the difference between a business that adopted technology and one that didn't was creating email marketing campaigns versus printing marketing flyers, now the difference will be the tech-friendly MSME's ability to launch substantial digital marketing campaigns with a simple prompt, with the ability to analyze the effectiveness of the campaigns and tweak them easily. The productivity lift for such a company could be considerable.

The effective use of data will rise in importance—and small businesses can struggle with this, from both a scale and sophistication point of view. Small and medium-size enterprises (SMEs) often have a wealth of data, and gen AI tools can help them leverage that data to grow their business.

So how can small businesses implement these technologies effectively? Here are several trends to consider:

— *Leverage public resources.* Many countries are advancing the digital public infrastructure agenda, making it more accessible. For instance, India has implemented the India stack, a collection of digital infrastructure components that third parties can use to build software integrated with state services. Additionally, several countries are promoting e-filing for taxes, compliance, and e-payroll. These initiatives boost nationwide formality and efficiency, while also offering small businesses the chance to improve their own efficiency. Small businesses can embrace these trends.

— *Harness the power of networks and interactions.* Interactions with other companies can help small businesses build digital muscle. For example, a large automotive company runs a comprehensive excellence program for its key MSME suppliers, including on digital skills. Creative collaborations among MSMEs are possible too. For instance, one construction developer built a digital platform to bring together specialist retrofitter microenterprises, enabling them collectively to undertake substantial contracts, leveraging their distinct expertise. Furthermore, many companies are launching new products and services to help SMEs leverage their data. For example, in financial services, an open data framework, which can enable financial institutions to use nontraditional data from SMEs for credit underwriting, can support underfinanced companies. In the United Kingdom, open banking facilitates the use of financial data by all kinds of companies to innovate on services.[1] Small businesses can collaborate with one another and larger companies to take advantage of these trends.

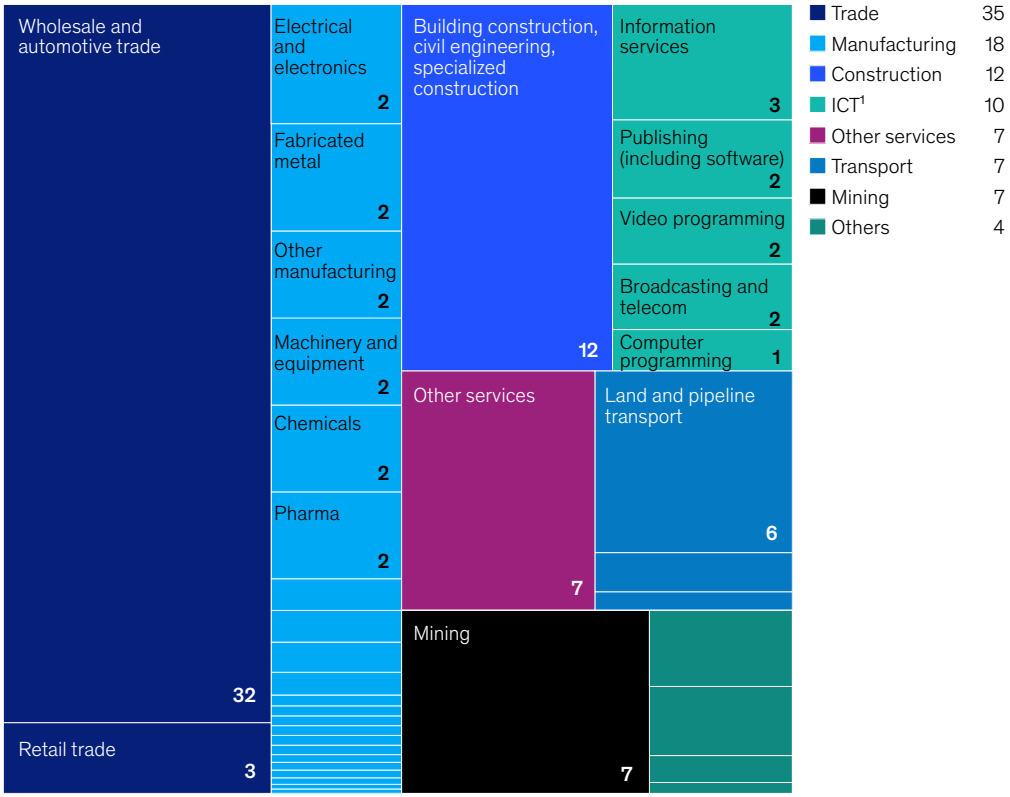
— *Strengthen in-house technical talent.* Businesses are concerned about hiring tech talent, but the supply of digital skills falls short of demand. As the overall skills gap widens, competition for these skills is likely to intensify, requiring MSMEs to be even more creative in attracting talent. The good news is that there are successful pathways for individuals from nontraditional backgrounds to break into tech roles. Our analysis of a quarter of a million online, public work history profiles revealed that more than 40 percent of workers in tech roles did not start their careers in tech occupations. They transitioned into those roles midcareer, demonstrating their ability to acquire skills such as web design, database administration, and cybersecurity, among others along the way. Small businesses can target candidates with adjacent skills who can learn quickly. Often, talent can be found among roles like operations and marketing managers, management analysts, graphic designers, or even customer service representatives.

[1] Chandana Asif, Tunde Olanrewaju, Hiro Sayama, and Ahalya Vijayasrinivasan, "Financial services unchained: The ongoing rise of open financial data," McKinsey, July 11, 2021.

Exhibit 9

Narrowing the productivity gap in the United States is equivalent to 5.4 percent of GDP—and ten to 15 subsectors contribute three-fourths of the potential.

Contribution of subsectors to productivity improvement in the US, %



Note: Year for which data are available is 2017. Micro-, small, and medium-size enterprises are those with fewer than 500 employees. Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households, and activities of extraterrestrial organizations.
[1]Information, communication, and technology.
Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business*, US Bureau of Economic Analysis; McKinsey Global Institute analysis

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The tremendous variation in MSME productivity ratios across countries suggests there is ample room for improvement in many sectors in the United States. While meaningful benchmarks vary based on local conditions, we compare the average productivity ratio of MSMEs to that of large US companies with a top quartile ratio across the ten advanced economies we studied at a subsector level.

Retail and wholesale trade, manufacturing, construction, and ICT account for the bulk of the productivity opportunity by virtue of their large share of national output and employment. The largest opportunity is in wholesale and automotive trade—which is almost 35 percent. In these sectors, MSMEs in the United States are only 38 percent as productive as large companies, a figure that is low relative to other advanced economies. For example, MSMEs in the automotive-trade sector in Japan are 62 percent as productive as large companies. They are more vertically integrated with large manufacturers, enabling efficient logistics that follow just-in-time principles and respond effectively to market fluctuations.[12] Similarly, wholesale trade MSMEs in Germany are 83 percent as productive as large companies. They benefit from market-leading innovation and vertical integration with upstream purchasers, such as retail supermarkets or distributors for large

manufacturers, across the entire European Union.[13] US businesses can take inspiration from these countries to improve their productivity.

Moreover, US manufacturing supply chains are realigning across the electronics, automotive, and pharma sectors, for example.[14] The CHIPS and Science Act offers new spending and opportunity for MSMEs tied to semiconductor manufacturing and R&D.[15] In the electronics industry, MSMEs generate 22 percent of value added, accounting for 2 percent of the productivity opportunity. The automotive industry accounts for another 2 percent, which may improve the competitiveness of the American electric-vehicle industry. Additionally, the recent surge in biotech investments is another opportunity for MSMEs. They generate 18 percent of value added in the pharmaceuticals, life sciences, and biotechnology sectors, and their productivity opportunity accounts for 2 percent of the total.

A competitive manufacturing economy requires efficient logistics, but in the United States, transportation companies are less efficient than their advanced-economy counterparts. MSMEs in the transportation sector account for 6 percent of the productivity opportunity.

As the United States works to rebuild its public infrastructure and improve its supply of housing stock, as well as undertake capital expenditures in building renewable energy infrastructure, there will be an increased demand for construction services, a sector particularly dominated by MSMEs, with significant room for productivity improvement. Twelve percent of the productivity opportunity can come from small businesses involved in construction. The productivity imperative is even more important in the context of labor force shortages in the construction sector.[16]

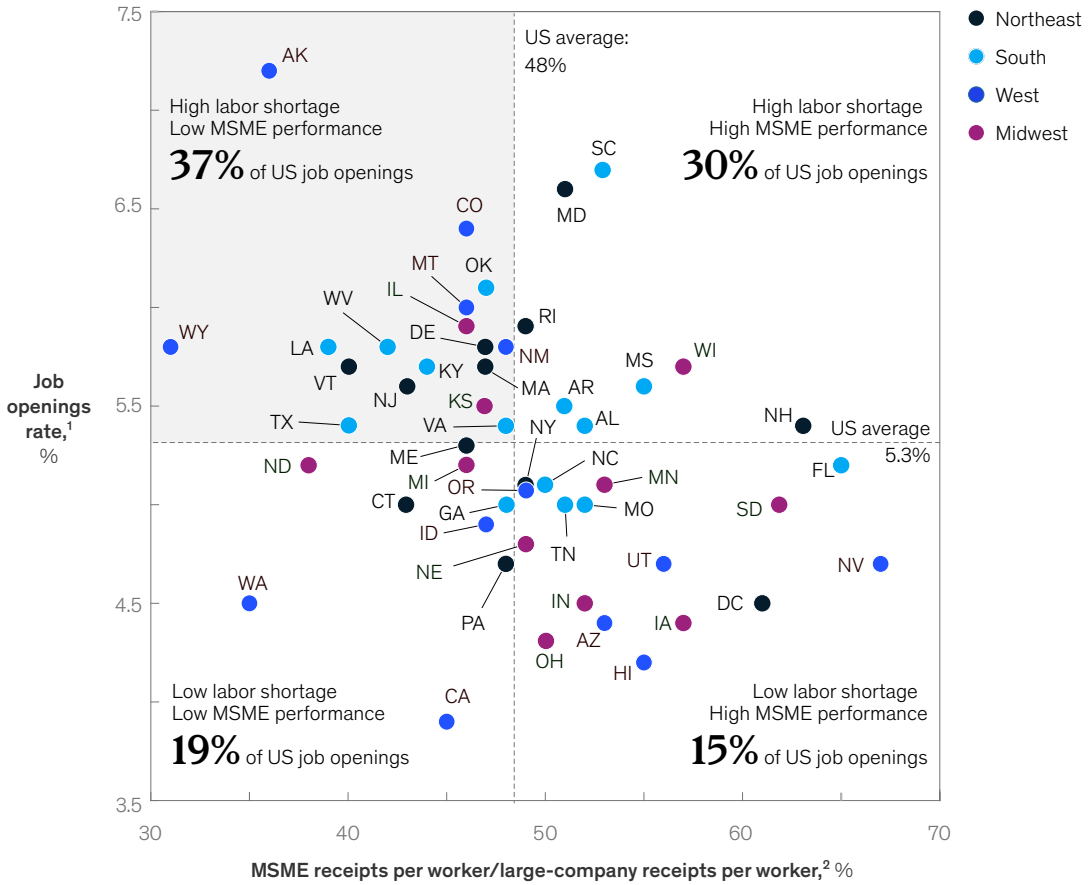
Labor market tightness in the United States is among the highest across advanced economies—making it challenging for the US economy to grow through employment alone. Almost three-fifths of job openings in March 2024 were in states with lower-than-average performance of MSMEs relative to large companies (Exhibit 10). Boosting MSME productivity could enable states to close that labor gap by offering workers higher pay and nonpay benefits, or by reducing hiring needs because they produce the same output with fewer workers. Either way, the small business gains.

Almost three-fifths of job openings in March 2024 were in states with lower-than-average performance of MSMEs relative to large companies.

Exhibit 10

Raising small-business performance is a priority in high labor shortage states.

Job openings and micro-, small, and medium-size enterprise (MSME) performance, by state



Note: Periods for which data are available are 2017 (MSME performance) and Q1 2024 (labor shortage). MSMEs are those with fewer than 500 employees. Analysis excludes the following sectors due to inconsistent data: agriculture, financial and insurance activities, real estate, public administration and defense, education, human health and social work, arts and entertainment, activities of households, and activities of extraterrestrial organizations.
[1]Defined as the number of job openings as a percent of employment plus job openings.
[2]MSME receipts per worker for each state are adjusted for regional price parities (RPP) in order to enable comparisons across states. An RPP is a weighted average of the price level of goods and services for the average consumer in one geographic region compared to all other regions in the US.
Source: "Job openings and labor turnover survey," US Bureau of Labor Statistics; "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business* and "Regional price parities by state and metro area," US Bureau of Economic Analysis; McKinsey Global Institute analysis

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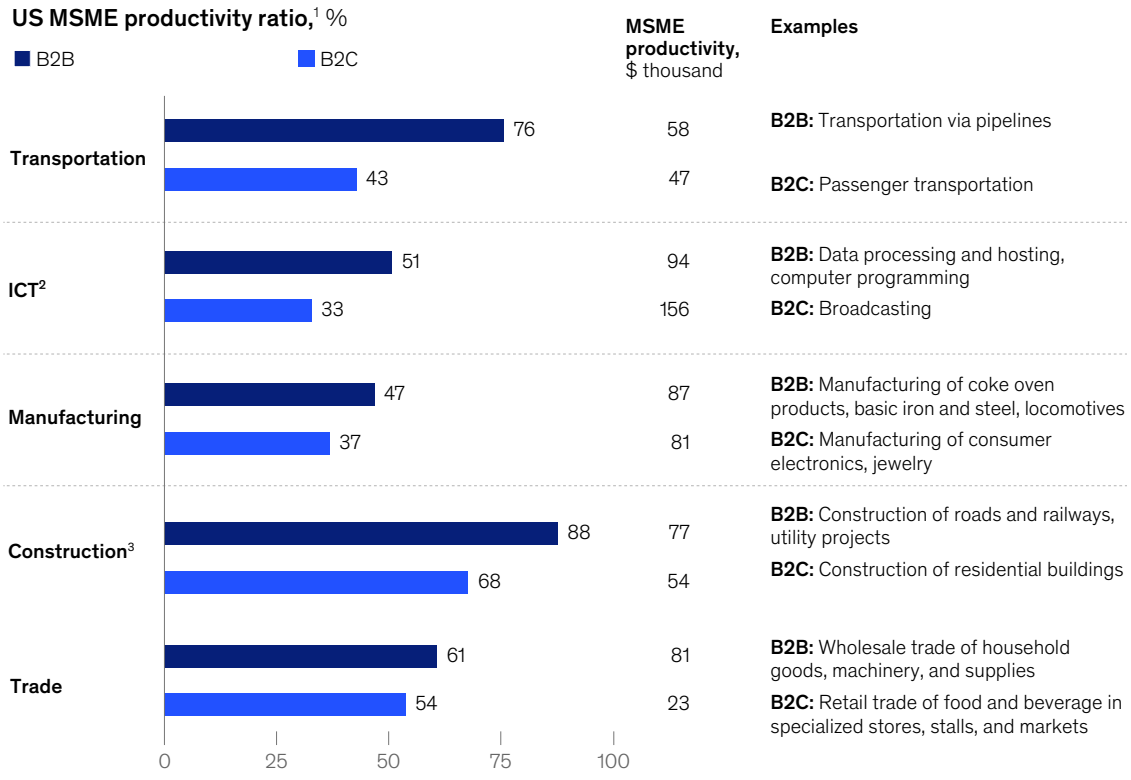
5. A path to higher productivity: Networks and interactions

For small businesses, the road to higher productivity involves accessing four key competencies: technology, human capital, market access, and finance. MSMEs struggle to access these competencies at the same level as larger companies, explaining wider productivity gaps in sectors where they are vital for competitiveness. How can small businesses better develop these competencies? An answer lies in what may seem, at first, an unlikely source: networks and interactions with other, usually bigger, businesses. Business-to-business interactions fuel MSME productivity and help them narrow the productivity gap (Exhibit 11).

Exhibit 11

Interactions between large and small businesses help productivity.



[1]Micro-, small, and medium-size enterprise (MSME)/large-company productivity ratio for B2B MSMEs vs B2C MSMEs.
[2]Information, communication, and technology.
[3]Includes "mixed" business models in the B2C construction sector, ie, business models where both B2B and B2C plays exist.
Source: "Nonemployer statistics," US Census Bureau; "Updated and expanded small business statistics," *Survey of Current Business*, US Bureau of Economic Analysis; McKinsey Global Institute analysis

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Businesses large and small should reconsider whether they have an adversarial approach to one another. Policies that attempt to create incentives, quotas, or protections that tilt the balance toward either small enterprises or larger ones aren't necessarily the solution. The truth—broadly—is that both MSMEs and large companies can benefit when they are operating within the right economic conditions.

Large companies could help smaller companies acquire competencies—but it's not a one-way street. Small companies help large companies as customers, suppliers, and sources of new ideas. In fact, the productivity of large and small companies tends to move hand in hand in most sectors. Boosting interactions between them could raise overall productivity for everyone.

Our analysis of a wide cross-section of subsectors across emerging and advanced economies suggests that MSME and large-company productivity move in tandem in most subsectors, indicating spillovers if the right conditions are established.

In the United States and in other advanced economies, there are multiple examples of win–win relationships between MSMEs and large businesses—templates for what has already worked. There are four kinds of models: larger companies innovating products and services targeted at helping small companies raise performance, intentional collaborative partnerships between small and large companies, more organically formed regional business clusters, and sector-wide infrastructure designed to boost intercompany connections.

— *Serving small-business customers with offerings that boost productivity.* MSMEs could interact with larger businesses as their customers. They could benefit from improving their overall efficiency and ability to invest in more technology and capabilities. Large companies can sell MSMEs productivity-boosting products and services and drive revenue growth. In short, small businesses could gain assets previously unavailable to them, and big companies could grow by selling those assets.

  Many small businesses have integrated with software-as-a-service (SaaS) providers to automate back-end operations and build capabilities in areas like compliance, tax, and accounting, thereby eliminating the need for people to perform these tasks. For example, a large HR solutions provider created a chat-based app specifically for small businesses to handle payroll. Another provider supports small businesses in hiring and onboarding. Other such collaborations help small businesses outsource managerial tasks, saving time for the owners at a fraction of the cost of a full-time employee, including tools for writing business plans, cloud-based project management tools, calendar tools for tracking time and building itineraries, and virtual assistants that record conversations, transcribe interviews, and generate summaries.

  MSMEs have also collaborated with other companies to expand their market reach, by utilizing products that enable them to accept digital payments, create content for marketing, and run an effective ad campaign. MSMEs are also integrating with providers to manage their finances in real time, seamlessly connecting with banks, accountants, and other business applications. And larger companies are using these digital footprints, such as merchant point-of-sale transactions, to enhance small business credit scores, helping businesses that might not otherwise qualify for financing.

— *Collaborative partnerships fostered through supply chains.* Collaborations between large and small companies can generate mutual benefits. Partnerships help larger businesses by giving them added resilience and flexibility—they also help MSMEs by building know-how, human capital, and market access. For example, in advanced-manufacturing industries, which require inputs from multiple suppliers such as semiconductors, automotive, and wind turbines, close collaboration between large integrators and suppliers helps suppliers reach new markets. Some contractual partnerships between Toyota and its suppliers have lasted for more than 30 years. Toyota has directly involved itself in raising the operational standards of its partners through knowledge transfer, from demand planning and cost reduction to raising management capabilities.[17] IBM, in collaboration with other Fortune 500 companies, launched the Supplier

Connection initiative that connects small suppliers to one another and to large businesses to access new opportunities.[18] One study of small businesses in New York found that seven in ten of them increased their revenue within two years of becoming part of a corporate supplier base.[19]

Sharing technology is a big part of the benefit. In the consumer-packaged-goods industry, large companies have improved the efficiency of fragmented suppliers by providing advanced digital and analytics tools that smaller companies do not have. The Global Lighthouse Network—a World Economic Forum initiative in collaboration with McKinsey[20]—has identified multiple companies that have achieved productivity improvements of up to 250 percent in some factories.[21]

Some companies have focused on lifting the capabilities of the small business workforce through training programs that help them succeed as suppliers. One example is Apple's $50 million fund to provide learning and skills development opportunities for the employees of its suppliers, launched in collaboration with the International Labour Organization and the International Organization for Migration.[22] Another is Nestlé's Nescafe Plan, which has provided training to small coffee farmers on techniques to increase crop yields.[23]

Finally, small companies can gain financial access by working with bigger companies. Some large companies use their relationships with financial institutions to advocate for small suppliers who may otherwise be unable to access credit or who may receive unfavorable rates. In Colombia, DuPont used its relationship with a financial institution to secure working capital credit for its MSME suppliers in rural areas. This, in turn, strengthened their supply chain and stabilized procurement.[24]

— *Vibrant, organically formed business clusters of large and small companies.* In some industries and areas, such as Silicon Valley or the furniture industry in Grand Rapids, Michigan, small and large companies have formed regional networks of people, ideas, and financing. Small companies gain from concentrations of capital and talent drawn to the area by universities and large companies. Large companies gain from the innovation and entrepreneurialism of smaller ones (for example, through acquisitions).

  In Sacramento, a different kind of cluster has developed. Like Silicon Valley, the Sacramento cluster boosts the area's natural advantages by connecting large businesses, start-ups, academic research, and private capital. But the Sacramento agtech cluster replaces silicon chips for wine grapes, synthetic proteins, and irrigation systems.[25] People add capabilities, too. Drawn by the University of California (UC), Davis, which has a strong agricultural science department, large companies conduct biotech research in the area; the concentration of research labs, educated labor force, and expertise gives small start-ups an advantage over similar-size competitors. One example is Scout, a vineyard management start-up founded by a tech executive and a professor at UC Davis.[26]

  The Sacramento cluster also provides infrastructure and financial access to MSMEs. Foodtech and agtech start-ups have access to wet labs, lab space, and manufacturing spaces that are set aside specifically for agtech start-ups. AgStart, a nonprofit, provides lab equipment, a commercial-grade kitchen, and event centers and has incubated more than 20 start-ups. Small businesses have gained access to capital, either through acquisition by another company, venture capital involvement, or public sector grants earmarked for developing the area.

— *Sector-wide infrastructure designed to boost intercompany connections.* Collaboration among companies could be encouraged by enhancing digital data and financial infrastructure, establishing a training ecosystem and creating a level playing field—in turn, fueling productivity for small businesses.

  An open data framework, for instance, could enable financial institutions to use nontraditional data sources for credit underwriting, targeted at a range of underfinanced companies, including MSMEs. An Experian study showed that including utility data allowed 20 percent of "thin file" credit customers—those with scant documentation to support their credit applications—to become "thick file" customers who have higher loan approval rates.[27]

A focus on boosting technical competence can enable growth among all companies, small and large. For example, while national labs are mandated to share research with companies, small companies seldom utilize these resources. Improving marketing efforts and providing incentives could encourage greater participation. Policy makers can play a role in promoting technology adoption. An example of this is Singapore's GoBusiness initiative, which provides financial support for all businesses that adopt technology solutions to improve their business processes, in line with industry road maps.

Establishing a training ecosystem can help MSMEs access crucial technical and strategic expertise. Examples include the United States' Manufacturing Extension Partnership (MEP), which provides small businesses with access to a national network of hundreds of specialists, who offer services ranging from supply chain management to industrial design, technology-driven market intelligence, marketing and sales, and more. The National Institute of Standards and Technology, which administers MEP, estimated that the program interacted with more than 36,000 small manufacturers in 2023, helping to create or retain more than 100,000 jobs.[28] For every dollar of federal investment, it also generated nearly $25 in new sales growth and $28 in new client investment, with a cumulative cost savings of nearly $3 billion.[29]

Greater collaborations among MSMEs can also raise productivity through knowledge sharing, mentoring, networking, and collectively benefiting from investments.


EXIT

6. What stakeholders can do to drive MSME productivity

Business leaders and policy makers can join forces to create a pathway to greater MSME productivity. Small businesses can start the process by working with one another.

There are three main considerations that could shape stakeholder actions: create a win–win economic fabric, adopt a granular and tailored approach, and foster networks and connections.

— *Create a win–win economic fabric.* The global business landscape is deeply interconnected. The success or failure of large companies can have ripple effects throughout entire economic ecosystems. As such, stakeholders, including policy makers, regulatory bodies, associations, and large companies need to foster the right enabling conditions for the growth and prosperity of all enterprises. These conditions may require measures that go beyond conventional policies focused on MSMEs, such as facilitating access to credit for MSMEs and encouraging training for MSME employees.

— *Adopt a granular and tailored approach.* Measures designed to help MSMEs improve their performance tend to be broad, but the granular lens of this research reveals that different subsectors have varied needs. Taking a microscopic approach that reflects the dynamics of each subsector and geography and that addresses barriers to productivity and scale in that context is warranted.

— *Foster networks and connections to build MSME competencies in technology, human capital, market access, and finance.* Strengthening networks between large and small businesses could yield productivity gains in subsectors where large companies outperform their global peers but smaller ones lag behind. Even where both do well, strengthening their interactions could boost productivity. Where small businesses outperform while larger ones do not, there would be benefit in enabling those small enterprises to evolve into large ones or merge with them to promote business dynamism. When both large and small companies lag behind their peers, building sector-wide infrastructure may be needed, for instance, investing in physical and digital infrastructure, establishing transparent and fair regulatory frameworks that boost competition, reducing trade barriers, and ensuring equal access to financial capital.

In many ways, what spurred the Napa wine industry to world-class status can happen across industries and regions in the United States. Just as Napa vintners shared resources and, in some cases, partnered with bigger wineries, industries as disparate as retail and construction can also use the tools afforded by existing, bigger players in their sectors.

Pushing productivity among MSMEs is essential as the United States seeks to remain a global economic powerhouse. Indeed, many of today's great American companies have humble beginnings. Nurturing a new crop of small American businesses will keep the US economy vibrant, its workforce growing, and its status strong for seasons to come.

Acknowledgments

This report is the latest publication in MGI's work on productivity and prosperity. The research was led by Olivia White, a McKinsey senior partner and a director of MGI in the Bay Area office; Anu Madgavkar, an MGI partner in New Jersey; Adi Kumar, a senior partner in the Washington, DC, office; Asutosh Padhi, a senior partner and global leader of firm strategy in the Chicago office; and Kanmani Chockalingam, an MGI fellow in the Bay Area office. The team comprised Brendan Mackie, Khalyani Shankar, and Shreyvardhan Sharma. The report was edited by David Weidner, a senior editor in the Bay Area office.

We give particular thanks for their guidance to MGI advisers Martin Neil Baily, senior fellow emeritus in economic studies at the Brookings Institution, and Matthew Slaughter, Paul Danos Dean of the Tuck School of Business and the Earl C. Daum 1924 Professor of International Business, Dartmouth College.

Finally, we want to thank a few colleagues who gave us input and guidance, namely Maria Arellano and Priyanka Agarwal, and other colleagues at MGI, including senior data visualization editor Juan M. Velasco; Chuck Burke, data visualization developer; digital editor David Batcheck; directors of communications Nienke Beuwer and Rebeca Robboy; Rachel Robinson, director of publishing; Rishabh Chaturvedi, assistant managing editor; and Ashley White, MGI communications coordinator. We are also grateful to Amanda Soto and Nathan R. Wilson, McKinsey lead designers.

This research contributes to our mission to help business and policy leaders understand the forces transforming the global economy. As with all MGI research, it is independent and has not been commissioned or sponsored in any way by any business, government, or other institution.

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[10] As a result, we adjust micro-, small, and medium-size enterprise (MSME) receipts per worker, depending on regional price parities in a state or metropolitan statistical area, but do not adjust large-company receipts. We adjust for all sectors equally. This approach has drawbacks in sectors such as mining, manufacturing, and information and communications technology, wherein a sizeable share of MSME revenue generation might be nonlocal. We estimate that this limitation could imply, approximately, a 15 percent variation around the mean. Similar limitations apply to large companies that might primarily generate receipts locally in certain sectors, such as a large restaurant chain only operating in a few states.

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October 2024

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