

STATE OF SMALL BUSINESS REPORT

AUGUST 2009: WAVE 2 OF THE SMALL BUSINESS SUCCESS INDEX

Why Do Small Businesses Matter?

According to the U.S. Census Bureau, the United States has 27 million small businesses with fewer than 100 employees; of these, 6 million maintain payrolls. The small business sector is responsible for over 40 million U.S. jobs and a staggering \$6 trillion in revenues, accounting for 98% of all businesses with payrolls and 36% of jobs. Small businesses are a vital source of innovation and commitment that drives the U.S. economy and they provide a path to personal independence for millions of Americans.

About the Small Business Success Index

Given the importance of the small business sector, Network Solutions®, LLC and the University of Maryland's Robert H. Smith School of Business have partnered to track the competitive health of small businesses over time. The baseline survey for the Small Business Success Index (SBSI) was collected in December 2008 through January 2009 by interviewing 1000 small business owners over the telephone. The second wave was collected in June 2009 from 500 small business owners. Small businesses included in the study are privately owned, for-profit, have fewer than 100 employees, and have a payroll and/or contributed to at least 50% of the owner's household income. The data are weighted to ensure representativeness to the entire population of small businesses in the U.S. The survey is longitudinal in nature, tracking small business trends over time; the completion of the second wave provides a six month trend line.

The SBSI is composed of 6 distinct dimensions, which combine to give a total competitiveness score, ranging from 0 to 100. Competitiveness in this study is defined as the level of success a small business achieves in conducting the organizational activities critical to its short and long term viability. The more competitive a small business is, the more likely it is to meet the personal and business goals of its owners and show positive financial results.

The survey is sponsored by Network Solutions, LLC and the Robert H. Smith School of Business, University of Maryland. Rockbridge Associates, Inc., an independent marketing research firm, conducted the survey.

The current global economic downturn, the worst since the Great Depression, is transforming the way businesses in the United States operate. For America's 27 million small businesses, this economic environment is creating challenges to their basic well-being and survival never before seen by today's owners. Yet even while they make tough choices and struggle to compete, small business owners remain satisfied with their vocation and cope by making their operations more efficient and finding innovative ways to meet customer needs. Small business optimism is rising, and if owners are correct, this sector can look forward to a bright future.

Despite the optimism, small businesses face major obstacles to success. The most important of these is Capital Access, a small business' ability to meet both short and long range financial needs, which small business owners struggled with even before the current capital crunch. Another issue that is prominent in the national debate on America's future relates to Workforce issues, including employee benefits, healthcare and regulation. Small businesses are limited in the benefits they are able to offer, especially in light of the recession and the changing regulatory environment.

This report describes the current landscape of small business in the U.S., discusses how the economic crisis is affecting businesses along various dimensions, and highlights the practices and characteristics of companies that have found success despite the turbulence that surrounds them.

THE SMALL BUSINESS SUCCESS INDEX

The Small Business Success Index (SBSI) measures success along 6 key functional dimensions and incorporates both internal (e.g. owner traits) and external (e.g. economic) factors that relate to small business competitiveness. The resulting competitiveness ranking, expressed as an index score ranging from 0 to 100, correlates to how well businesses perform at meeting stated business goals and outcomes.

	JUNE 2009	GRADE	JAN. 2009	WEIGHT
SBSI INDEX	75 →	C	75	100%
Capital Access	69 ↗	D+	68	33%
Marketing & Innovation	70 ↘	C-	71	23%
Workforce	78 →	C+	78	14%
Customer Service	91 ↗	A-	90	11%
Computer Technology	75 →	C	75	11%
Compliance	89 →	B+	89	8%

How competitive are small businesses today?

Small businesses earned a 75, or a solid C, on the June 2009 SBSI survey. This rating remains unchanged from the January 2009 score, exposing how the deepening recession has restrained the ability of small businesses to improve in light of tighter credit options and falling consumer demand.

Small businesses can be classified into four groups, based on how they rank against the overall SBSI:

- 24% are Highly Competitive (SBSI score 85 plus)
- 28% are Marginally Competitive (SBSI score 75 - 85)
- 26% are Marginally Failing (SBSI score 65 - 75)
- 20% are Failing (SBSI score under 65)

Success on the SBSI reflects the bottom line. Owners of businesses in the “highly competitive” category are the most successful in meeting financial targets and business goals like growing, avoiding risk, and creating owner wealth, while those in the “failing” category tend not to meet these same objectives. 71% of highly competitive businesses earned a profit in their most recent fiscal year, compared to only 38% of those in the failing group and 56% of all companies overall. Only 11% of the highly competitive businesses reported a loss, compared to 43% of those that had a failing index score.

Who are the most competitive small businesses?

Some interesting characteristics emerge after examining the group of highly competitive small businesses:

- Highly competitive small businesses are more likely to have multiple owners (51%) than small businesses classified as failing (33%). While businesses with multiple owners tend to be larger, there is also an advantage to having multiple stakeholders providing capital and making decisions.
- Highly competitive businesses are more likely to be women-owned (38%) than failing businesses are (22%).
- Highly competitive businesses are more likely to be mature businesses (71%) than failing ones are (34%). Highly competitive businesses are also less likely to be early growth businesses (16%) than failing ones are (44%). The competitiveness gap between early growth and mature businesses has increased substantially over the past six months, as the recession is making it harder for businesses just starting out.

What is the small business mindset?

Small business owners are generally satisfied with their career choice, perhaps the ultimate measure of success, and are optimistic about the future. Only 5% of all owners are unhappy with their lot; even among the failing enterprises, only 11% are dissatisfied with being an owner. Owners are also optimistic about their long-term prospects: two-thirds (65%) of small businesses that expect to be operating in five years also think their sales will be bigger than they are now, with only 1% projecting sales to shrink.

This optimism is telling about the commitment of America’s small business owners: they generally enjoy what they are doing, despite having only modest success in meeting many business goals. Small businesses are least successful at building their personal wealth (32% are highly satisfied, 23% are failing), improving profit margins (only 33% are satisfied), growing revenue (34%), and growing as fast as desired (35%). On the other hand, small businesses are currently enjoying the greatest success in their ability to minimize costs (57% consider themselves highly successful) and reducing risks (50%).

THE SMALL BUSINESS ECONOMIC CLIMATE

Six months ago, small business owners expressed their expectation that the economy would continue to decline; they are living this reality now. Even so, they are getting more optimistic about the future and their companies’ prospects once the recession eases.

- More small businesses think the economic climate for their business is worsening (38%) rather than improving (25%). However, the level of pessimism is far less than six months ago when 46% believed it was worsening and only 14% believed it was improving.
- More small business owners expect the economy to improve in the next 12 months (38%), than decline (28%). When asked the same question six months ago, the mood was darker with only 23% expecting improvement and 48% expecting decline.
- As many small businesses believe their 2009 revenues will be higher than in 2008 (29%) as think it will be lower (30%), with 38% expecting revenues to be the same.
- Nearly half (46%) of small businesses believe they have been seriously impacted by the downturn in the economy, compared to only 36% six months ago. The

recession has had at least some impact on three out of four small businesses. 40% of owners have had to accept a lower standard of living, 30% say the recession has hurt company morale, and 19% have been forced to reduce valuable staff.

Despite these effects, the economy has instigated certain positive outcomes for many businesses. Many businesses have found ways to operate more efficiently (66% cite this outcome), as well as become a better team (42%), find new products and services that benefit customers (42%) and reduce inefficient or unnecessary staff (26%). These outcomes will make small businesses more competitive in the long run because they are reducing costs and innovating on behalf of the customer.

What happens after the recession?

Small business owners are optimistic that their performance will improve once the economy recovers. Nearly half believe that customers will actually spend more after the economy improves than they did before the downturn; an additional 45% think customers will spend at the same level. Only a small portion of owners (8%) are concerned that their customers will spend less after the economy recovers. Small business owners likely feel their customers, who are currently holding back, will have pent up demand once the recovery begins.

Once the economy improves, small business owners' main concerns will be rebuilding their financial reserves, not just their businesses. Due to the credit crunch, many owners have turned to their personal assets for funding, including dipping into personal savings, cutting their own pay, borrowing with credit cards and/or taking out home equity loans to finance their businesses. It is therefore not surprising that the most often cited priority (25%) after the recession eases will be to replenish the owners' savings. Similarly, 11% plan on building an emergency fund for the business as a way of preventing the need to turn to owner income and savings in the future.

The emphasis on replenishing capital first, rather than immediately investing in growth, will lessen the bump in small business spending on infrastructure and marketing that would typically follow economic recovery. Even though small businesses have recently been forced to cut back, they will also likely try to avoid future personal

exposure by keeping staffing and overhead low to ensure there are sufficient reserves for the next downturn.

SBSI DIMENSIONS

CAPITAL ACCESS

The single biggest driver of success for small businesses, accounting for a full one-third of the overall SBSI rating, is their performance in the Capital Access dimension. Unfortunately, most small businesses struggle with this critical area, particularly with having enough capital to meet long-range needs. A third of small businesses (34%) feel that their inability to obtain financing is impeding their growth objectives, and 30% feel that their working capital is not sufficient to operate their business today.

How do small businesses meet their capital needs?

Small businesses are at a disadvantage accessing the traditional loans and investments that larger businesses enjoy, and are instead relying on the owners' personal wealth and income to fund their business needs. Aside from cash on hand, the most common sources of small business capital over the past two years have been credit cards (33%), cutting owners' pay (33%), and dipping into the owners' savings (32%). Business owners that did not show a profit last year are far more likely to rely on these three sources than those who did turn a profit. About a third of businesses rely on traditional bank lines of credit and 1/5 get loans from a bank. The image of the small business as an entrepreneurial firm relying on investors and SBA loans is far from reality, as these sources are rarely used: only 3% take SBA loans and 4% get money from angel investors.

Another troubling finding is that over half of small business owners have noted that at least one of their capital sources has shrunk over the past year, especially owner savings (21%) and credit cards (20%), where lower limits and spending restrictions have become more common.

WORKFORCE & BENEFITS

Workforce management is another significant area that is currently undergoing changes. Problems in this area, which includes morale and benefits, have a broad social significance to the one-third of U.S. workers employed by the small business sector. When the economy does improve, many small businesses will begin to expand, requiring them to compete for employees and making workforce development more critical.

	JUNE 2009	JAN. 2009
SBSI INDEX	75	75
Capital Access	69	68
Getting advice needed to manage financial aspects of your business effectively	75	74
Always having enough working capital to fund your short term needs	68	69
Having enough capital internally or externally to invest for the long term	64	63
Marketing & Innovation	70	71
Getting your customers to refer new customers	78	79
Coming up with new ideas that increase revenue for your business	71	71
Identifying prospective customers	70	71
Coming up with new ideas before your competitors	70	71
Positioning your organization as having the same capabilities as big organizations in your industry	69 ↘	71
Finding efficient ways to advertise and promote your business	65 ↘	67
Converting marketing leads into buyers	66 ↘	68
Workforce	78	78
Providing the information employees need to service customers	86	85
Managing employee turnover	83	83
Encouraging employees to offer new ideas to help grow the organization	80	79
Training and developing employees	79	78
Maximizing the productivity of your staff	78	77
Providing the right rewards to employees to motivate them	78	78
Providing attractive benefits to your employees	64 ↓	68
Customer Service	91	90
Answering customer questions	93	92
Ensuring your customers are satisfied	91	90
Convincing your customers you care about them	91	91
Providing consistent service to your customers	90	90
Solving customer problems quickly	90	89
Winning repeat business from current customers	89	89
Computer Technology	75	75
Making technology work effectively in your business	77	76
Deploying technology to make your business run more efficiently	74	74
Compliance	89	89
Complying with laws and regulations	93	92
Keeping customer information secure	93	92
Keeping up to date on laws and regulations	83	83

What benefits do small businesses offer?

Many small businesses are frustrated by their inability to provide attractive benefits to employees. Among those who maintain payrolls, only 41% consider themselves highly successful in providing benefits. This figure has fallen 7% compared to six months ago as businesses have had to cut back on spending even while costs are rising.

Among small businesses with two or more staff on payroll, 48% provide paid vacation and sick leave and 43% provide health insurance. Less commonly offered benefits include enhanced insurance options such as dental, life or disability; retirement plans; and matching employer contributions. Benefit offerings vary by industry, reflecting the workforce needed for particular businesses. Health insurance is offered by 62% of professional services firms, but only 25% of those in entertainment, food, and lodging industries; in practice, a small law firm needs to offer benefits to attract employees, while a restaurant may not have to because it has a more transient workforce.

As the economy has tightened, many small businesses have cut back on their benefit offerings, including retirement and savings plans. 15% of small businesses have reduced retirement benefits and 3% have cut them completely, while 14% have cut employer matching.

Health insurance benefits have changed significantly over the past 12 months, especially in the face of escalating costs, with two out of five small businesses either increasing (19%) or decreasing (22%) the benefit level. While 48% of owners cite the rising costs as a “major problem” to their coverage offering, the larger small business are especially affected; 73% of companies with 20 to 99 employees consider the rising costs a major problem. These businesses feel the impact of cost increases compounded across all their employees, but lack the negotiating power of a larger firm. 34% consider the ability to afford quality providers to be a major problem, and small businesses cite issues such as pre-existing conditions, complexity and employee satisfaction as problematic to offering health care benefits, as well.

Although some businesses actually increased their spending on health coverage over the past year, they were likely absorbing rising costs, rather than offering more comprehensive coverage.

COMPUTER TECHNOLOGY

Small businesses leverage a range of internet solutions and information technologies to augment their marketing, service and operational efficiency. The most common technologies include email customer service (64%), a company website (53%), and online advertising in directories (39%). The number using email is significantly higher than the number with websites, indicating that many small business owners still use email providers like AOL, Yahoo or Gmail as their business account, which may hurt their credibility with potential customers. The most notable increase in technology over the past six months has been in companies with social media presence, which has growing from 12% to 17%.

The SBSI tracks the penetration of 14 technologies in total, and over the past six months use of 12 of these has increased modestly. Future plans to deploy additional technologies have been scaled back since six months previously, which comes as no surprise as companies have reduced spending across the board. For example, plans to offer customers online payment options have fallen from 15% six months ago to 10% now.

How does technology correlate to small business success?

In the previous wave of the SBSI, it was found that the most “plugged-in” or “tech-powered” small businesses – ones that used 6 to 14 of the technologies tracked by the survey – were far more competitive on the SBSI than those deploying fewer Internet business solutions. Surprisingly, the June 2009 wave revealed that relationship to be weaker than originally thought; businesses with minimal technology were nearly as competitive as the tech-powered ones. This is likely due to falling demand in the current economic climate, which has restricted the effectiveness of companies’ marketing efforts. Internet business solutions have their greatest impact on success in the Marketing and Innovation area of the SBSI, but in an environment with declining sales, the weak economy blunts the benefits of these technologies.

Tech-powered companies are also more likely to be start-ups or early growth companies, which have been most seriously affected by the downturn because they tend not to be financially self-sufficient and fail in the vital Capital Access dimension. Small businesses may also be increasingly turning to technology solutions like social media tools out of desperation and because they are free, but fail to craft an effective strategy around these efforts that ties them to their core business aims.

Effectively deployed Internet businesses solutions such as online directories, online advertising, and quality websites coupled with search engine optimization can greatly augment a company’s marketing performance and enable small businesses to scale up customer acquisition quickly and efficiently once the economy rebounds. Now, while business is slow, is therefore the ideal time to deploy and perfect these internet technologies.

SMALL BUSINESSES IN AMERICA

Who is the typical small business owner?

The SBSI survey provides a wealth of information on owner and business characteristics based on reports by the owners themselves. Small businesses, as defined by the SBSI, have a payroll of fewer than 100 employees and/or provide half of the owner’s household income, which leaves out the minor side-businesses that account for a small share of U.S. output and jobs.

Small business owners cross a wide spectrum of demographic groups, so it is not possible to describe a “typical” owner. Compared to the general population, however, the small business owner tends to be older, is more likely to be male, highly experienced, and relatively affluent. Additionally:

- The median age for a small business owner is 49.5 years, and one out of six (17%) work past the traditional retirement age of 65
- 29% are female
- Over half have a four-year college degree (51%), but 20% have no more than a high-school diploma, and 28% have attended trade school, only some college, or hold a two year degree
- 56% have worked in their industry for 20 or more years
- 82% of owners started the business
- 83% work in their business full-time

What do small businesses in America look like?

A typical small business has a single owner, operates within a local area, has a single location, and has sales in the low six figures. However many do have multiple locations and operate on a global scale. Additionally:

- On average, small businesses have 1.7 owners; 57% have a single owner, 34% have two owners, and 8% have 3 or more owners
- 10% are minority-owned
- 28% are women-owned
- 63% small businesses operate just in a local metro area, 15% operate in multiple states or metro areas, and 21% have national or international coverage
- 85% have just a single location
- The average age of small businesses is 15 years
- Over a third of small businesses are just getting started; 6% are start-ups and 32% are early growth businesses
- 51% are considered mature businesses
- 10% are in various phases of closing or being sold or transferred
- The median annual revenue is \$189,000; among those reporting their sales, 39% gross less than \$125,000.

COMPLIANCE

Although it is of minor importance to the overall SBSI ranking, compliance is a growing concern among small businesses as the regulatory environment changes with the new administration. Small businesses generally perform well in keeping customer information secure and complying with regulations, but have a little more trouble keeping up to date with changing laws and regulations. Government agencies and trade associations can help by providing readily accessible information on compliance, such as web sites that allow searching by industry.

Small businesses are also noticing growing regulatory burdens in certain areas, including environmental laws, tax compliance, accounting rules, and privacy and data security. The weight of these laws falls differently across various industries; environmental laws are more of a concern for small business in the agriculture, mining, and construction industries, while privacy and data security are more important to professional services firms.

SUMMARY

The coming months will prove challenging to small businesses as they continue to cope with the recession, as well as try to rebuild their businesses and their reserves to help spur on a larger economic recovery. By continuing to cut costs, optimize their operations, and find innovative ways to serve their customers, small businesses can prove to be up to the challenge. Now is the time for small businesses to start exploring technologies and online solutions that will help them reach new markets and grow their business during the rebound. When owners approach these tools in a strategic manner that integrates with their larger business goals, the results can be an immediate and impactful increase in competitiveness. By coupling these efforts with strong improvements in the area of capital access, small businesses will be poised for success.

About the Small Business Success Survey

The Small Business Success Index, an ongoing measurement of the overall health of the U.S. small business segment, was commissioned by Network Solutions, LLC and the Robert H. Smith School of Business, University of Maryland. Rockbridge Associates, Inc., an independent marketing research firm, conducted the survey.

Network Solutions, LLC
13861 Sunrise Valley Dr.
Suite 300
Herndon, VA 20171

Robert H. Smith School of Business
University of Maryland
3461 Van Munching Hall
College Park, MD 2074

Media Inquiries
Susan Wade, Director of PR
for Network Solutions, LLC
703-668-5057
swade@networksolutions.com

Carrie Handwerker, PR Associate
for Robert H. Smith School of Business
301-405-5833
chand@rhsmith.umd.edu