The State of Small Business Report

December 2009 Survey of Small Business Success

January 8, 2010

Sponsored by: **Network Solutions, LLC and the Center for Excellence in Service at the University of Maryland's Robert H. Smith School of Business**

Presented by: **Rockbridge Associates, Inc.**

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Introduction

The prolonged downturn is taking its toll on small business owners, forcing them to cut their pay and take steps to increase efficiency. This dire environment has not stifled innovation. The most successful small businesses are competing by offering superior service and creativity, and small businesses are rapidly embracing social media as a way of keeping them engaged with customers and tapping knowledge resources. The year ahead will be critical in determining the success of small business, and there is cautious optimism that the economic environment will improve.

Because of the importance of the small business sector, which accounts for over one out of every three jobs in the U.S., 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 survey is conducted by telephone and the baseline survey wave (Wave 1) was fielded a year ago in December and January among 1000 small businesses. A second survey wave (Wave 2), was conducted in June with 500 small business owners, and a third wave (Wave 3) was completed in December 2009 with another 500 small business owners, providing six month trending increments for the past year. (The methodology is discussed in greater detail in the last section of this report, *About the Small Business Success Survey*.)

A central focus of the SBSI is competitiveness, which is defined here 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 Small Business Success Index (SBSI) is composed of 6 distinct dimensions that capture competitiveness, as shown in the report card in Figure 1.

Figure 1

Small Business Success Report Card

	Importance Score**	Index Score*	Grade	✓
OVERALL INDEX SCORE*		**75**	**C**	
Sub-Indices				
Capital Access	33	67	D+	
Marketing & Innovation	23	70	C-	
Workforce	14	79	C+	
Customer Service	11	91	A-	
Computer Technology	11	74	C	
Compliance	8	90	A-	

***Index Score is calculated on a 0-100 scale**

****Importance Score is calculated proportionally, meaning that the total of the numbers across all the sub-indices is 100%**

The SBSI ranges from 0 to 100, and is currently 75, which can be viewed as a “solid C”. This level is unchanged from a year ago, and other data reported here suggest that the prolonged recession has restrained the ability of small businesses to improve their situation. While the overall numbers are largely unchanged, small shifts are occurring on selective indicators of success. For example, small businesses feel more successful in getting their customers to help find new business for them and in keeping their staff productive. It would seem that customers and employees alike are doing their best to help small businesses deal with tough times. This wave of the SBSI provides considerable detail on how the economy is affecting small businesses and how they are responding.

A major obstacle small businesses face today is in the highly important area of capital access, which consists of a small business’ ability to meet short and long range financial needs. The report for this wave sheds light on this problem, with details and trends on how small businesses finance their needs and how the capital crunch affects owners personally. This wave of the SBSI also provides depth on other issues and opportunities for small businesses, including the triggers of entrepreneurship, where small businesses get new ideas, the rise of social media as a marketing and management tool, and the global reach of small enterprises.

Executive Summary

Creativity as a strategy for success. As noted in the scorecard above, small businesses perceive themselves at a disadvantage in marketing and innovation. Common marketing methods for reaching potential customers include print advertising (37 percent), email marketing (24 percent), social media marketing (19 percent), telephone sales (18 percent), direct mail (17 percent) and broadcast advertising (14 percent).

Small businesses are highly successful in getting referrals from existing customers, but struggle to be creative and differentiate themselves. The major ways that small businesses differentiate themselves from competitors are:

- Superior customer service (78 percent)
- Higher quality products and services (76 percent)
- Creative ideas to address customers’ needs (65 percent)
- Lower prices (44 percent)

Among these four areas of differentiation, *superior service* and *creativity* are correlated with competitive success, while quality and low prices make little difference to small business success. Perhaps everyone claims to have high quality, making it a marginal strategy for differentiation, while cutting prices is not sustainable for small enterprises that lack the economies of scale to keep costs low.

Being creative is a success strategy for differentiation, but where do small businesses get new ideas for how to grow? The most common source is customers (68 percent). Other popular sources include:

- Newsletters and trade journals (52 percent)
- Competitors (50 percent)
- Employees (45 percent)
- Suppliers (41 percent)
- Conferences (38 percent)
- Books (37 percent)

Sources for ideas vary by industry. For example, retailers will rely more on customers while professional services firms will rely more on conferences.

A social media boom. One technology application that is experiencing substantial growth is a social media presence, such as having a blog, FaceBook page or LinkedIn profile. The incidence of small businesses having a social media presence has doubled from 12 percent to 24 percent in the past 12 months.

Almost one out of five small business owners actively uses social media for a part of their business. The main types of social media uses include:

- A company page on a social networking site (75 percent)
- Posting status updates or articles of interest on social media sites (69 percent)
- Building a network through a site like LinkedIn (57 percent)
- Monitoring feedback about the business (54 percent)
- Maintaining a blog (39 percent)
- Tweeting about areas of expertise (26 percent)
- Using Twitter as a service channel (16 percent)

Does social media pay? The majority of small business owners who use social media – 58 percent – feel the medium has so far "met expectations." Another 12 percent feel it has "exceeded expectations" but twice as many, 26 percent, feel it has "fallen short of expectations." The major accomplishments of social media so far are related to marketing and service, and include:

- Identifying and attracting new customers (61 percent of users)
- Developing higher awareness of the business in its target market (52 percent)
- Staying engaged with current customers (46 percent)

Social media also helps some small businesses to collaborate effectively with their network of suppliers, partners and colleagues (35 percent) and among employees (21 percent). This collaboration has the potential to spur productivity and creativity among small businesses as their connectivity rises exponentially.

Social media is not without problems. For example, half (50 percent) of users feel it has used up more time than expected. Only 17 percent feel social media has resulted in allowing people to criticize their business, though experts would note this provides a chance to engage critics (only 6 percent feel social media has hurt the business image through negative comments more than helped it). How has social media affected the bottom line of small business?

- Looking at the past 12 months, only 22 percent believe social media use has been profitable; 19 percent believe it lost money, and 53 percent believe it just paid for itself.
- The future is brighter as small business owners learn to master the medium. Almost half (45 percent) expect social media to be profitable in the next twelve months.

A static technology environment. Many small businesses rely on various internet business solutions for marketing and operations. With the exception of social media, the prevalence of most of these solutions has not changed much in the past year, and a few have even dropped slightly. For example, web site ownership dropped slightly (4 percentage points) and is now at 46 percent. This static growth or decline in some applications is most likely due to the poor economy, with businesses cutting back or undergoing changes such as moving from an outside office to a home. Other solutions, such as online ads in directories, increased a few percentage points. There is a good chance that adoption of these technologies will accelerate if the economy recovers because a substantial share of small businesses plan to get new technologies like websites, online customer service and social media in the next two years.

The Economy: A silver lining in a dark cloud. The recession has had some positive effects on small businesses, including leading them to:

- Find more efficient ways to operate (72 percent)
- Find new products and services to meet customer needs (47 percent)
- Become a better team (43 percent)
- Reduce inefficient or unnecessary staff (31 percent)

However, the prolonged recession is also starting to have a demoralizing effect on small businesses. To illustrate:

- 52 percent have discounted their products and services in response to the recession, compared to 40 percent who indicated they did so six months ago – this growing behavior correlates with failure (vis-à-vis the SBSI) and may be unwise because it saps margins and hurts quality perceptions
- 43 percent have experienced lower staff morale, compared to 30 percent six months ago

As a result of the recession, many small businesses have also been required to do the following:

- Accept a lower standard of living (42 percent)
- Make pay cuts (35 percent)
- Reduce employee benefits (29 percent)
- Shorten the work week (25 percent)
- Make reductions in valuable staff (23 percent)
- Implement furloughs (13 percent)

Has the economy hit bottom? The economy is a major factor holding back the success of small businesses. The economic outlook deteriorated in the first half of the year, and has not improved between June and December.

- Half of small businesses – 50 percent – have been highly impacted by the downturn in the last 12 months, compared to only 36 percent a year ago. In the past six months, the recession has touched more small businesses. In June, one out of four small businesses (25 percent) had been minimally impacted by the recession, but by December, less than a fifth (19 percent) had been minimally impacted.

- There is more pessimism than optimism about the economy, and sentiment has not yet turned. Looking to the next 12 months, 36 percent of small business owners believe the economy will improve while 26 percent expect it decline. While more optimistic than a year ago, this sentiment is largely unchanged since June.

- A third of small businesses (33 percent) lost revenue between 2008 and 2009, while only a fourth (24 percent) gained.

- In June, 56 percent of small businesses had made a profit for their most recent fiscal year, but as the year closes, only 47 percent expect to make a profit in 2009. A fourth (26 percent) of small businesses expect to lose money in 2009.

Vanishing finances. One of the major challenges for small businesses during the recession has been access to capital, which is the most important factor driving their success but the area with the worst performance (D+). The sources of funding relied on by small businesses has changed markedly in the past 6 months as cash reserves and traditional funding sources have disappeared. The following are steps taken in the past two years and how this has changed since the last survey wave in June:

- Almost half of small businesses (46 percent) have met their capital needs by cutting their own pay; just six months ago, only a third (33 percent) had resorted to this step
- 42 percent have had to take a loan from owner savings, compared with only 32 percent six months ago
- 39 percent have relied on credit cards (compared to 33 percent in June)
- 33 percent used a business line of credit (compared to 31 percent in June)
- 21 percent used a bank loan (20 percent in June)
- 14 percent took out a home equity loan (10 percent in June).

Few have relied on outside investors (5 percent) or SBA loans (4 percent), and only a fifth report having relied on no special funding sources in the past two years. Bank loans have become increasingly scarce. A fifth (18 percent) of all businesses indicate the source has gotten scarcer in the past year, compared with just 13 percent noting this in June; among those who took out bank loans, 43 percent believe the source is getting scarcer.

Striving for a dream. A full 60 percent of small business owners are highly satisfied with their profession, rating satisfaction 8, 9 or 10 on a scale of 0 to 10. Satisfaction levels have trended downward, though not significantly, since June of this year. Small business owners are most successful in minimizing costs. They are not highly successful in growing their businesses or building wealth. Success in meeting goals has not changed much in the past year, and the prolonged recession is certainly not helping.

Most small business owners started their business. The most common reason for doing so is to be one's own boss (42 percent). Other less common reasons include a desire to own a company (27 percent), capitalizing on a business idea (27 percent) and a desire to build wealth (25 percent). Only 6 percent started their company because they could not find employment.

Global players. A final note on the story of small businesses in America is the surprising degree to which they operate globally. While globalization among big business is often associated with sending jobs overseas, small businesses are more likely to export goods and services outside the country than to import them.

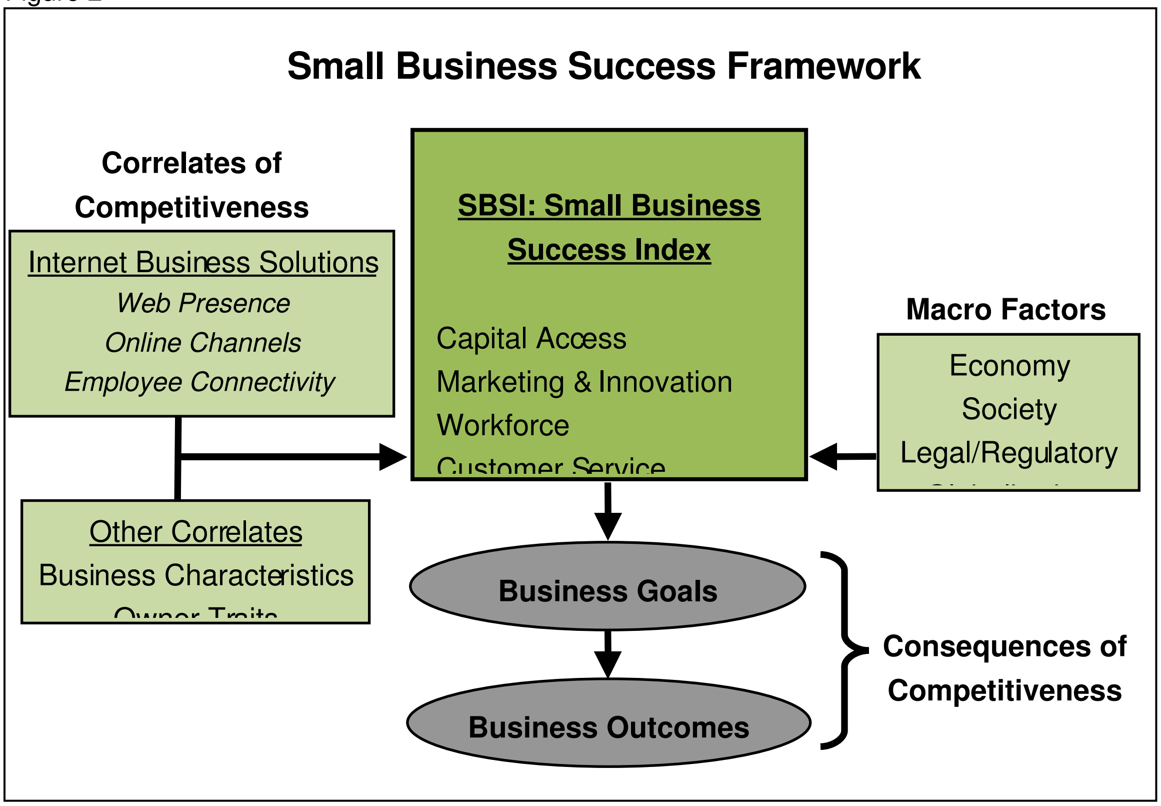
- 19 percent of small businesses sell goods or services to customers in other countries, and 9 percent consider the bulk of their business coming from outside the U.S.
- 11 percent procure goods or services directly from suppliers in other countries
- Only 2 percent have employees in other countries.

The following discussion presents more detail on the SBSI, what this research is showing about the drivers of small business success, and the latest findings and trends on views on the economy, capital access, innovation and technology.

The Small Business Success Index

This research is based on a holistic approach to gauging the health of small businesses, as captured in the Small Business Success Framework (see Figure 2). At the heart of the framework is "competitiveness," a multi-faceted construct that is measured with the Small Business Success Index (SBSI). The framework goes beyond the SBSI to also capture the outcomes or consequences of competitiveness, as well as other factors that relate to competitiveness, both internal (such as owner traits or technology usage) and external (like the economy or regulation). These areas are covered in the survey questionnaire, and their linkages were validated in the baseline study (December2008/January 2009).

Figure 2



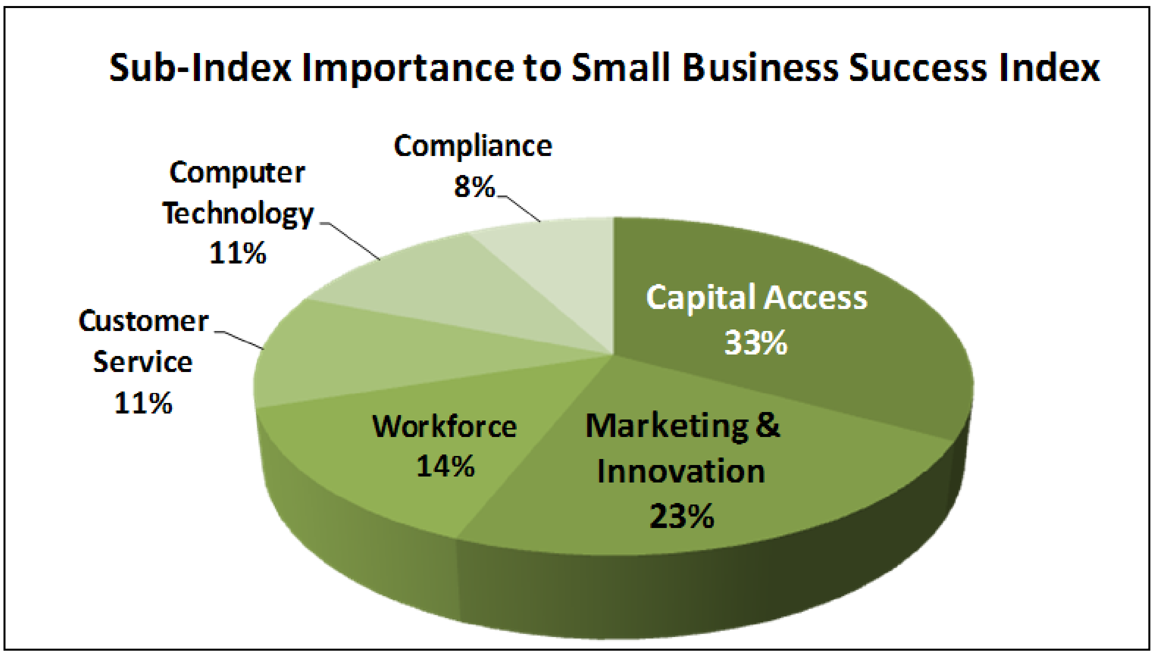
Small Business Success is measured on several dimensions and quantified on a scale of 0 to 100 (completely failing to completely successful). The SBSI is based on 28 measures, which capture the six dimensions (or sub-indices) below:

- **Capital Access**, including availability of working capital, capital for long term investments, and expert financial advice
- **Marketing and Innovation**, such as identifying new prospects, showing effective corporate positioning, converting leads, finding ways to efficiently advertise, and the ability to come up with new ideas
- **Workforce**, including the ability of small businesses to attract, retain, develop, motivate and deploy employees efficiently, as well as encourage creativity from them
- **Customer Service**, which is the ability of small businesses to service their customers, show they care about them and grow their relationships

- **Computer Technology**, which includes making technology work effectively and efficiently in the organization
- **Compliance**, which is the ability of the small business to understand and comply with laws and regulations, including ensuring data security

These dimensions have varying importance in a small business's overall SBSI score. For example, performance in Capital Access has the most impact on overall competitiveness, accounting for one-third of the total competitiveness score (see Figure 3). Marketing and Innovation is also highly important, making up almost one-quarter of the SBSI score. These weighting factors, which sum to 100%, are based on the degree to which each sub-index is able to explain a small business's perceived success in meeting broad goals such as building wealth, growing, and providing an attractive income and lifestyle for the owners.

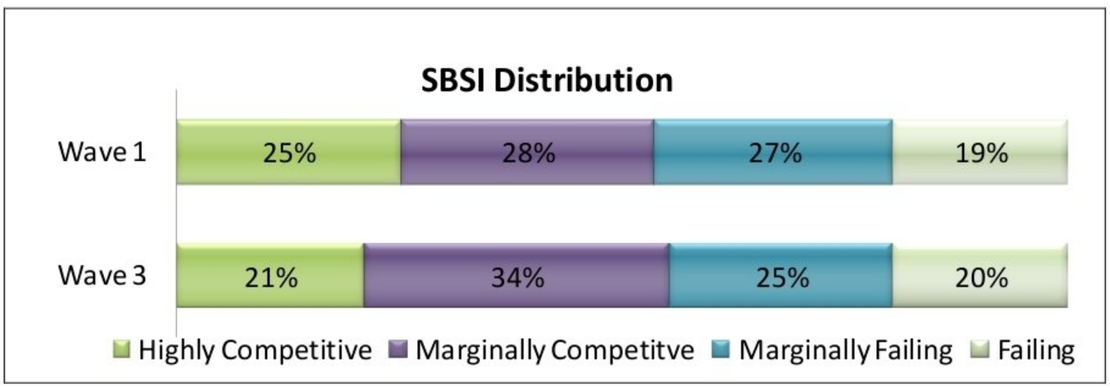
Figure 3



How competitive are small businesses today? As of December 2009, when the most recent wave of the SBSI survey was completed, small businesses had an SBSI score of 75. This can be considered a middling rating, or the equivalent of a ‘solid C’. Based on their scores, individual small businesses can be classified into four competitiveness groups (see Figure 4):

- 21% of small businesses are **Highly Competitive** (an SBSI score of 85 or higher)
- 34% are **Marginally Competitive** (an SBSI score of at least 75 but less than 85)
- 25% are **Marginally Failing** (an SBSI score of at least 65 but less than 75)
- 20% are **Failing** (an SBSI score below 65).

Figure 4



Competitiveness, as measured by the SBSI, relates strongly to the ability of a small business to succeed in meeting broad business goals. Owners of businesses in the “highly competitive” category largely believe they have successful businesses; for example, the businesses are growing, creating wealth, avoiding risk, and meeting the owners’ expectations for income and an attractive lifestyle. In contrast, those in the “failing” category tend to be failing in meeting these broader goals, and those that are “marginally failing” can be deemed as not in a crisis but clearly not successful in meeting the owners’ expectations.

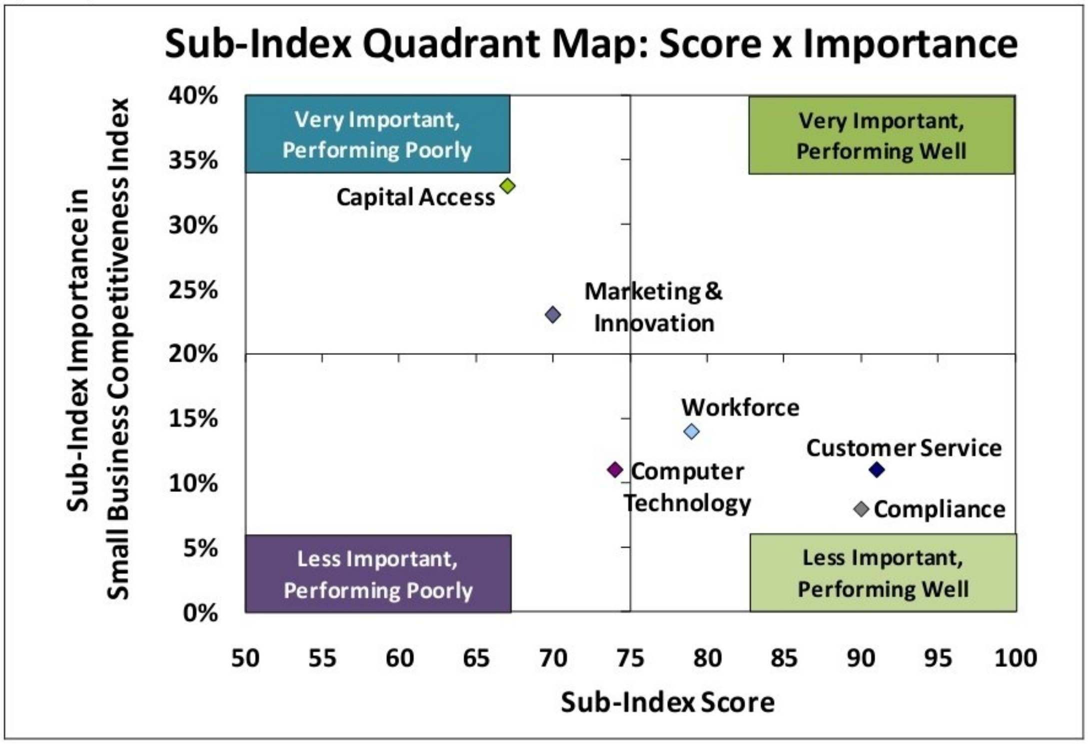
The SBSI has not changed since the baseline one year ago (December/January 2009), when it was still 75. At the time of the baseline survey in December/January (Wave 1), small businesses were facing challenges from the economic downturn which at that point had been in force for just over a year. A year later (Wave 3), the economic situation has worsened, constraining the ability of small businesses to improve their competitiveness. As discussed later, this is most pronounced in the critical areas of Capital Access due to shrinking financial resources, and Marketing and Innovation, due to a lack of growth in revenues.

By looking at how small businesses score on each sub-index of the SBSI, a more detailed picture emerges of small businesses' strengths and trouble spots. Small businesses are struggling the most with Capital Access, earning the equivalent of a 'D+' on this sub-index (see Figure 5). Another area where they are at a competitive disadvantage is Marketing and Innovation (the equivalent of a 'C–'). On the other hand, small businesses excel at Customer Service, which can be graded as an 'A–', and small businesses do almost as well in Compliance. None of the individual sub-index areas has changed significantly in the past year. The prolonged economic downturn likely has restrained the ability of small businesses to improve their competitive health. Later discussion sheds more light on some of these areas, particularly Capital Access, where the recession is taking a toll, and Marketing and Innovation.

Figure 5

What are the top priorities for making small businesses more competitive? By comparing the importance of each sub-index with its overall score, it becomes apparent which strengths and weaknesses have the most impact on the ability of small businesses to succeed in the future. The quadrant below (Figure 6) provides this perspective by comparing performance on each index dimension with its importance.

Figure 6



The quadrant map reveals just how important Capital Access is in affecting the ability of small businesses to compete. As noted later, the impact of the recession has worsened over the past year and the financial resources of small business owners have diminished, with many having to finance their enterprises by cutting pay and relying on personal assets. The map also reveals that Marketing and Innovation is not just a weak area, but a highly important one. Later discussion highlights how small businesses that seek creative solutions to meet customer needs are more successful in this economy. The discussion also reveals how leveraging internet technology improves competitive success, and that small business is rapidly embracing social media as a way to engage customers.

The Workforce dimension is classified in the quadrant labeled “less important, performing well.” However, it is on the border of other quadrants, being the highest in importance and the lowest in performance in its quadrant. If the economy rebounds, the C+ score could pose a problem. For now, the economy has forced many small businesses to downsize and cut pay and benefits.

The discussion on the six areas also reveals some interesting trends in the less critical performance areas. Small businesses do not perceive themselves at a competitive disadvantage in the area of regulatory compliance, but there is a perception that regulation is becoming more burdensome, which may be due to aggressive activities by governments to make up revenue shortfalls. Small business is effective in customer service, and later discussion reveals that superior service is a successful strategy for market differentiation.

The next six sections provide more perspective on each of the six areas in the index, including:

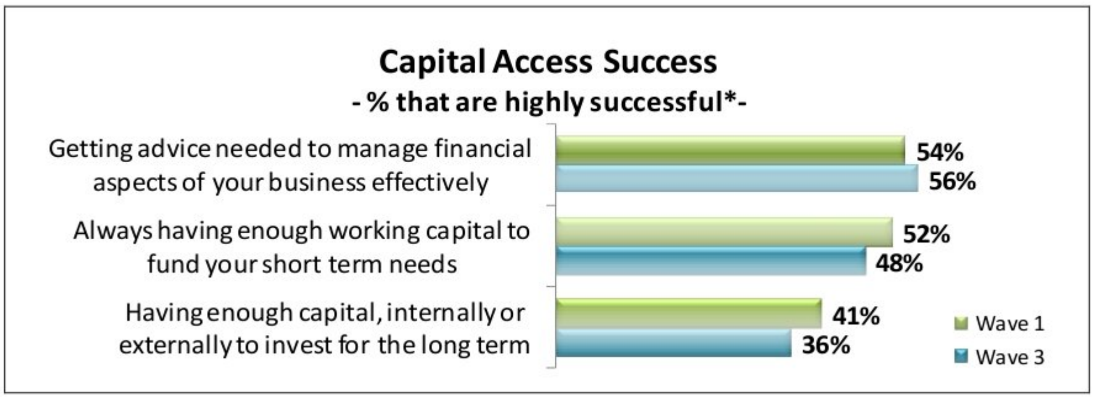
- Capital Access – this section includes fresh data on how small businesses finance their needs
- Marketing and Innovation – this includes new data on innovation and the use of social media such as FaceBook, LinkedIn and blogs
- Workforce
- Customer service
- Computer technology – this includes information on the growth of various technologies and their role in small business success
- Compliance.

The report concludes with fresh information on the impact of the economy and the outlook for the future. It also provides a profile of small businesses, including their involvement in selling and buying internationally.

Capital Access for Small Businesses

The single biggest constraint to small business success is Capital Access, a situation which is worsening as the recession continues. This component of the SBSI is measured by three indicators (see Figure 7). While most small businesses are able to get solid financial advice, barely less than half are successful in meeting their short-term capital needs and only a third are successful in meeting long-term investment needs. Success in accessing capital has worsened in the past year (though not statistically significant). In 2010, small businesses will face serious challenges in financing their long-term needs. As discussed below, a contributing factor is that owners have had to make financial sacrifices to keep their enterprises running, meaning they will need to rebuild their working capital resources before they can start investing for the long term. This will be a period when traditional financing sources such as bank loans will be in demand.

Figure 7



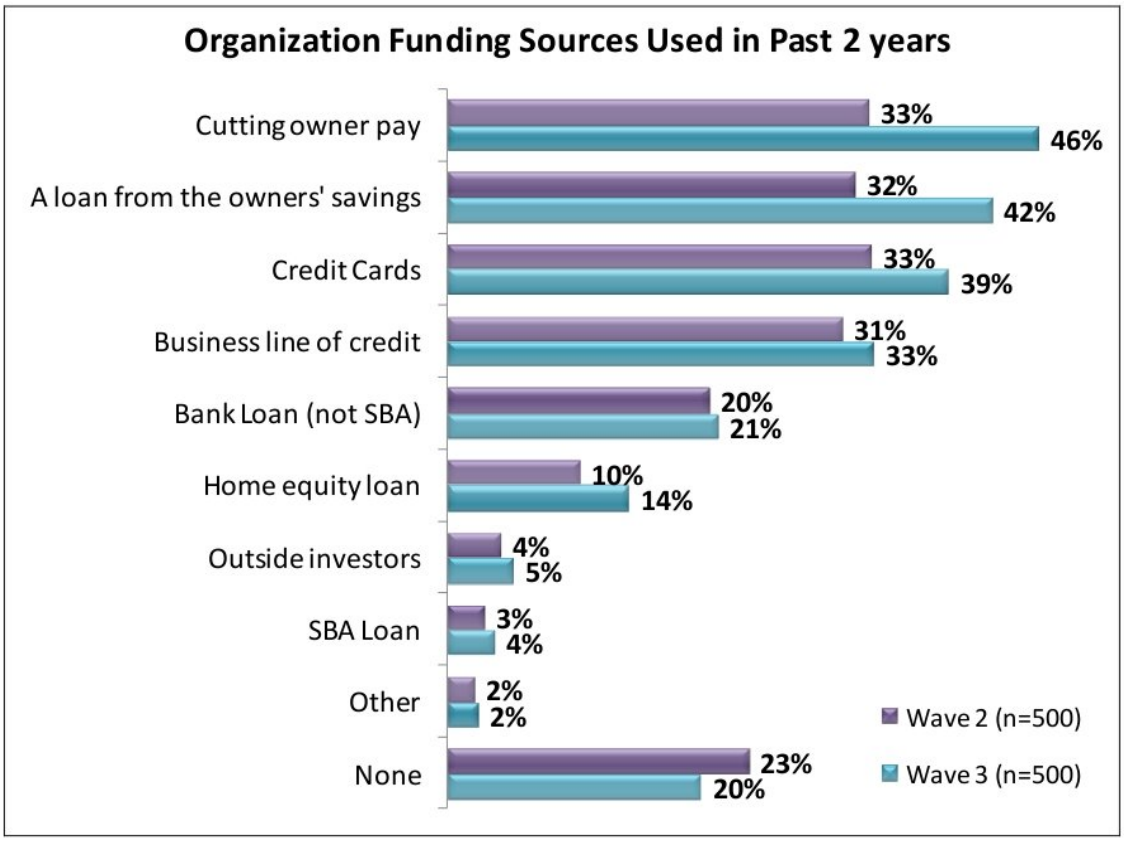
*Rated 8 to 10 on a 0 to 10 scale, where 10 = completely successful.

As further evidence of problems in capital access, small business owners reported the following:

- 33 percent do not have working capital that is sufficient for their business today, up slightly from 30 percent in June
- 37 percent feel that a lack of access to capital is impeding their growth objectives, up slightly from 34 percent in June
- These questions are not just academic – the way owners answer them has a strong relationship to competitive success; for example, 61 percent of businesses classified as “failing” on the SBSI do not have sufficient capital, compared to only 11 percent of those classified as “highly competitive”.

As of December, the top two funding sources for small businesses have been cutting owner pay (46 percent did so in the past two years) and a loan from owner savings (42 percent). Usage of these two sources has grown significantly over the past six months and is now more prevalent than credit cards, bank lines and bank loans (see Figure 8). As in previous waves of the SBSI Survey, small business loans and investors are insignificant as sources of financing for owners. Given the spike in reliance on personal assets, it is a reasonable assumption that small businesses are becoming less credit worthy to obtain financing in the future.

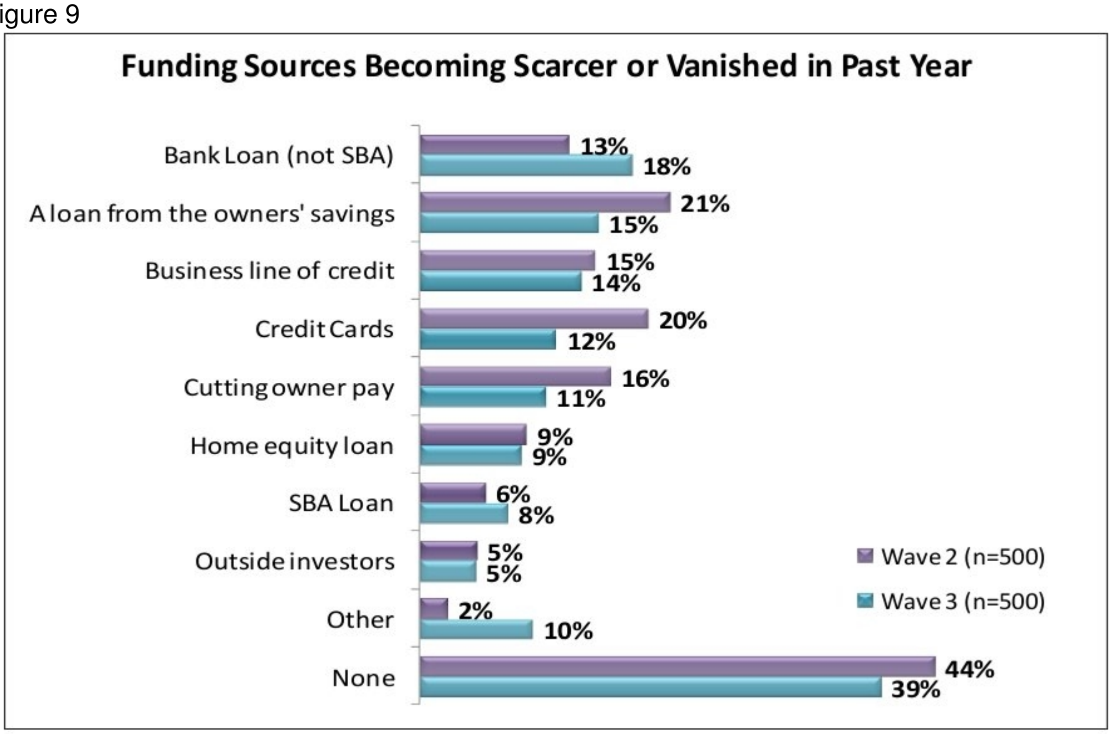
Figure 8



Owners were asked if they perceived that any sources of financing had become scarcer or vanished in the past year (see Figure 9). Among all small business owners, the most often cited source that is getting scarcer is bank loans – 18 percent of small business owners believe bank loans are becoming scarcer or vanishing, and the share is up significantly from six months ago (13 percent), indicating that the problem is getting worse. The problem with bank loan availability is understated here because not all of those asked the question rely on this type of credit. Among small businesses that *have used bank loans in the past two years*, 43 percent believe this financing avenue is becoming scarcer.

Other credit sources are viewed as becoming scarcer by at least a tenth of small business owners. A full 14 percent believe business lines of credit are becoming scarcer, but the incidence is 25 percent among those who have relied on the source in the past year. Another 12 percent believe credit card financing is becoming scarcer, but the incidence is 23 percent among those who have relied on credit cards.

Figure 9

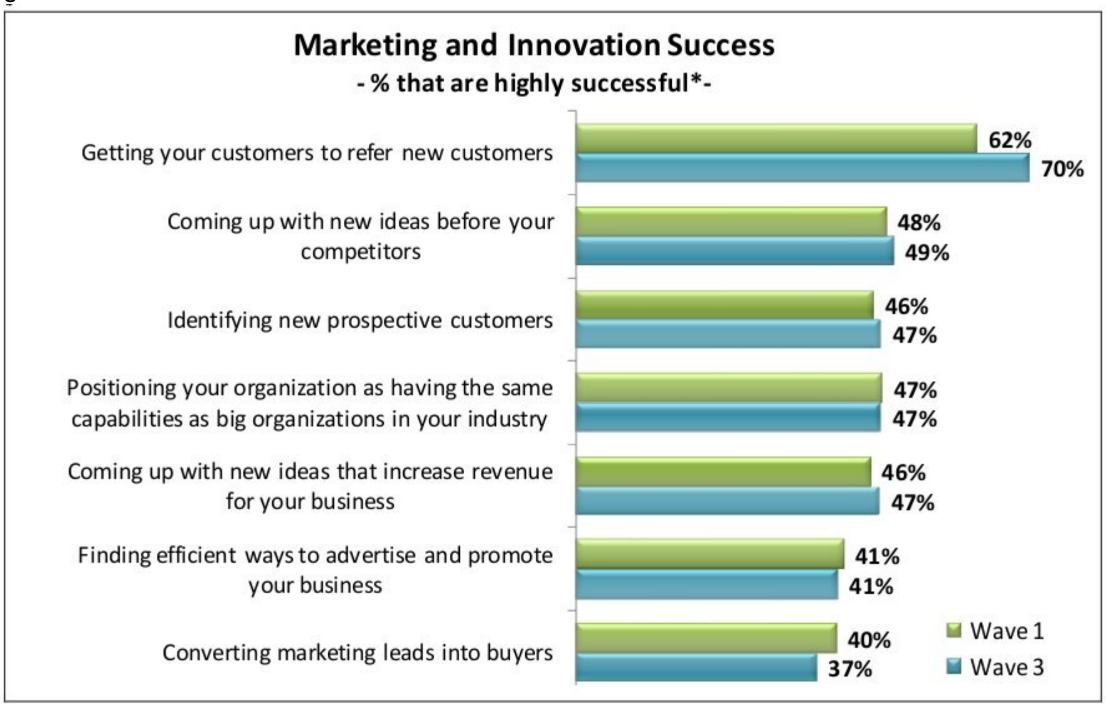


To summarize the capital situation for small businesses in America, capital resources are getting stretched as access to bank loans drops and owners start tapping into their own savings. As noted in a later section, many have also started cutting their own pay as a result of the recession.

Marketing and Innovation

Marketing and Innovation is the second biggest indicator of small business success (after Capital Access). As noted in Figure 10, this area is determined by seven measures of success.   The majority of small business owners feel successful in only one area, getting existing customers to refer new customers. A full 70 percent are highly successful in this area, which is significantly higher than a year ago. One possible explanation for this improvement is that customers of small businesses are helping the businesses weather the lengthy recession by making referrals.

Figure 10



*Rated 8 to 10 on a 0 to 10 scale, where 10 = completely successful.

The marketing area of greatest failure for small businesses is in converting leads into buyers, with barely a third citing success in this area. Less than half of small businesses are successful in indentifying new customers, positioning themselves as having the same capabilities of larger competitors, and finding efficient ways to advertise. The limited success in these areas has not changed much since a year ago.

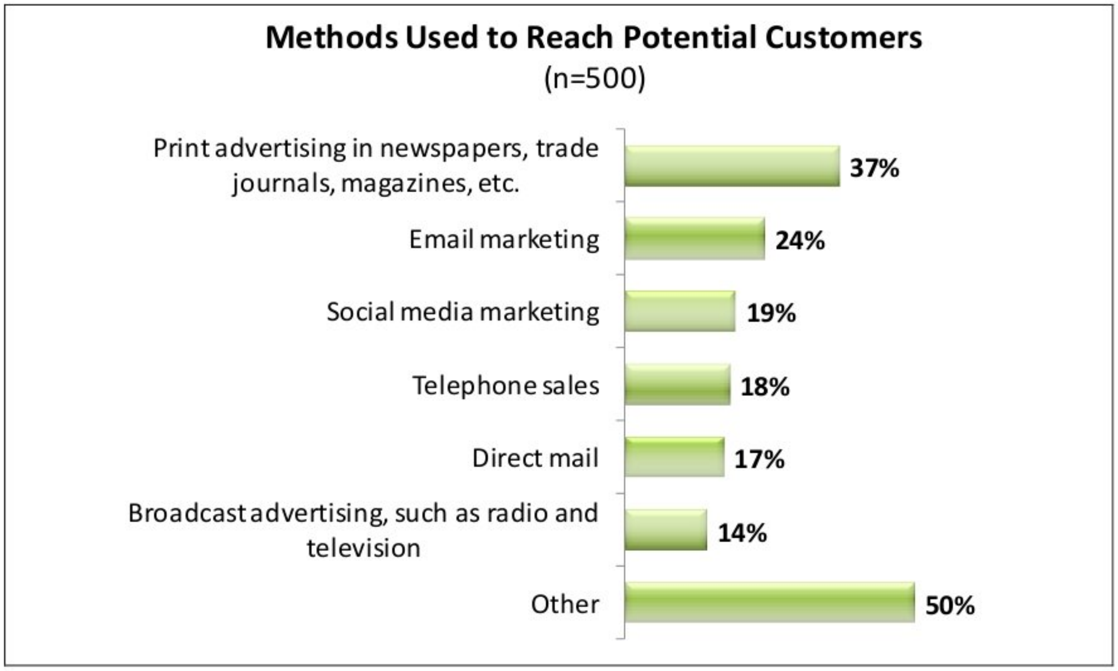
Finally, slightly less than half of small businesses are successful in innovation, which includes coming up with new ideas before competitors and finding ideas to increase revenue. Again, not much has changed in the past year.

The most recent SBSI wave examined marketing and innovation in greater detail, including the methods used by small businesses to attract new customers. When asked about six common categories used to obtain new business, the most common method – relied on by over a third of small businesses – is traditional print advertising such as newspapers, trade journals, and magazines (see figure 11). After this, email marketing is the second most common method used by a quarter of small businesses, and social media marketing which is used by a fifth. Half of small businesses do not use any of the six standard categories for marketing leads, but the majority of these "other" channels consists of reliance on referrals and word-of-mouth; this includes direct referrals, leads that come to the business because of its general reputation, or referrals by other businesses. Besides referrals, "other" types of marketing methods tend to be idiosyncratic methods related to the business such as:

- Walk-in traffic
- Outdoor advertising such as signs and vehicles
- Farm markets, craft shows, etc.
- Conferences, trade shows, and meetings (e.g., the Chamber of Commerce)
- Agricultural commodities markets
- Directories (print and online)
- Personal selling and cold calling
- The GSA Schedule for federal government business
- Volunteering in the community.

The methods used for acquiring new customers vary by industry. For example, professional services firms, real estate businesses and entertainment/food/lodging businesses rely more on email marketing than other types of small businesses. Firms in the education/health/social services sector rely more on social media marketing and direct mail. Not surprisingly, retailers depend more on print and broadcast advertising.

Figure 11



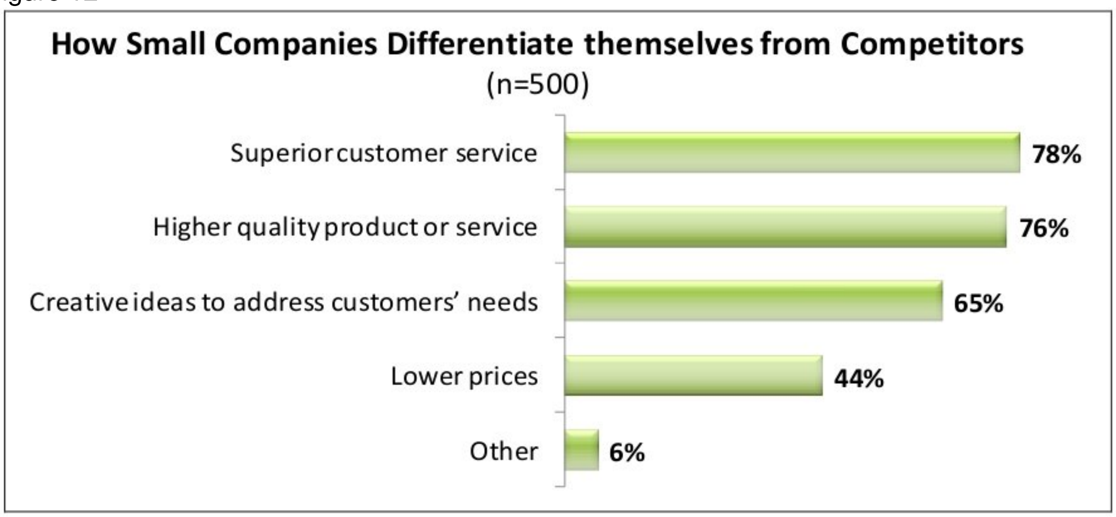
In the current challenging environment, small businesses may rely on different approaches to differentiate themselves from the competition. Over three out of four small businesses rely on the strategy of offering *superior customer service* and *higher quality* products and services. Almost two-thirds rely on *creativity* while four out of 10 compete on *price* (see Figure 12).

Of these four methods, two have a direct relationship to success while two make little difference in success. The strategies that contribute to success are as follows:

- Superior service – this is used by 90 percent of “highly competitive” small businesses but only 73 percent of “failing” small businesses
- Creative ideas to address customer needs – this is used by 78 percent of “highly competitive” enterprises compared to only 53 percent of “failing” enterprises.

Competing on quality probably does not help a small business become successful because quality is usually a prerequisite for being in business. Poor quality may put a company out of business, but superior quality does not differentiate it successfully since competitors will also purport to offer high quality. Competing on price is not a sustainable strategy for a small business because larger companies will always win due to their economies of scale. For example, a small retailer cannot under-price Wal-Mart because the latter has the ability to buy in large volumes and pass through lower costs.   What many large companies lack are impeccable service and creative problem solving.

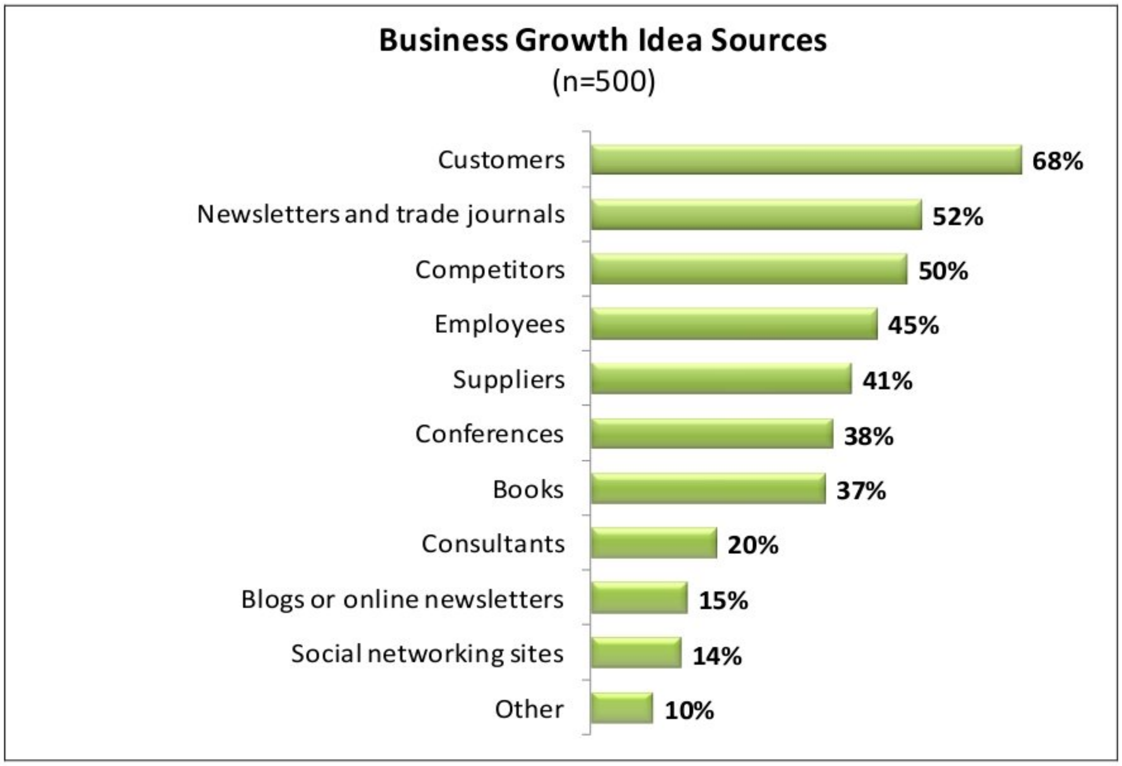
Figure 12



Because creativity is important to small business success, the SBSI Survey asked owners where they get their ideas. The most common source of ideas, relied on by two-thirds of small businesses, is customers (see Figure 13). Other common sources include newsletters and trade journals, competitors, employees, suppliers, conferences and books.

The sources used for ideas depend on the industry. Wholesale/retail firms rely mainly on customers and suppliers for ideas. Conferences are more important for industries that rely on providing expertise rather than goods, including professional services, real estate and education/health/social services firms; while not the top source of ideas for these businesses, over half the businesses in these industries rely on conferences.

Figure 13



Workforce

Small businesses are moderately successful in the workforce area. Given the state of the economy with its high unemployment, small businesses are not struggling to motivate employees or to make them productive. Out of seven dimensions that are part of the workforce area in the SBSI, six improved between 2 to 8 percentage points in the past 12 months (see Figure 14). Increases were significant for two workforce areas: providing the information employees need to service customers, and maximizing the productivity of staff. Productivity in particular is an area that can rise in an environment where workforces are shrinking and businesses learn to do more with fewer people.

Only one workforce dimension, providing attractive benefits, is successful for a minority of small businesses. This area also dropped from a year ago, although the decline was not statistically significant. The report for the June 2009 Wave of the SBSI provides greater detail on employee benefits, including areas that have been cut and problems with providing healthcare for employees.

Figure 14

*Rated 8 to 10 on a 0 to 10 scale, where 10 = completely successful.

Customer Service

The major strength of small business is in customer service, with the great majority of businesses reporting success in all six areas that comprise this component of the SBSI. Around nine out of ten small businesses are highly successful at answering customer questions, ensuring customer satisfaction, showing empathy, providing consistent service, resolving problems and winning repeat business. Four of the six customer service dimensions have gotten stronger compared to a year ago, and one of these, ensuring customer satisfaction, is significantly higher.

Clearly, the negative economic environment is not hurting the ability to satisfy existing customers. It will be worth seeing in the future if the situation changes in a growth economy where there are greater volume pressures and employees are harder to find and motivate. Right now, customer service success is only gaining.

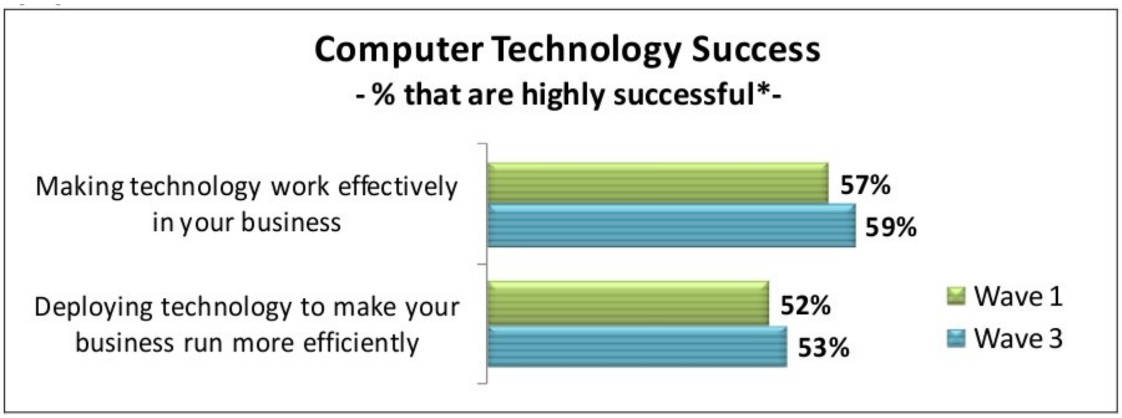
Figure 15

*Rated 8 to 10 on a 0 to 10 scale, where 10 = completely successful.

Computer Technology

Technology is an area where small businesses are moderately successful. Success in this area has grown slightly in the past year, though the changes are not statistically significant (see Figure 16). Small businesses have greater success making technology work effectively than in deploying it.

Figure 16

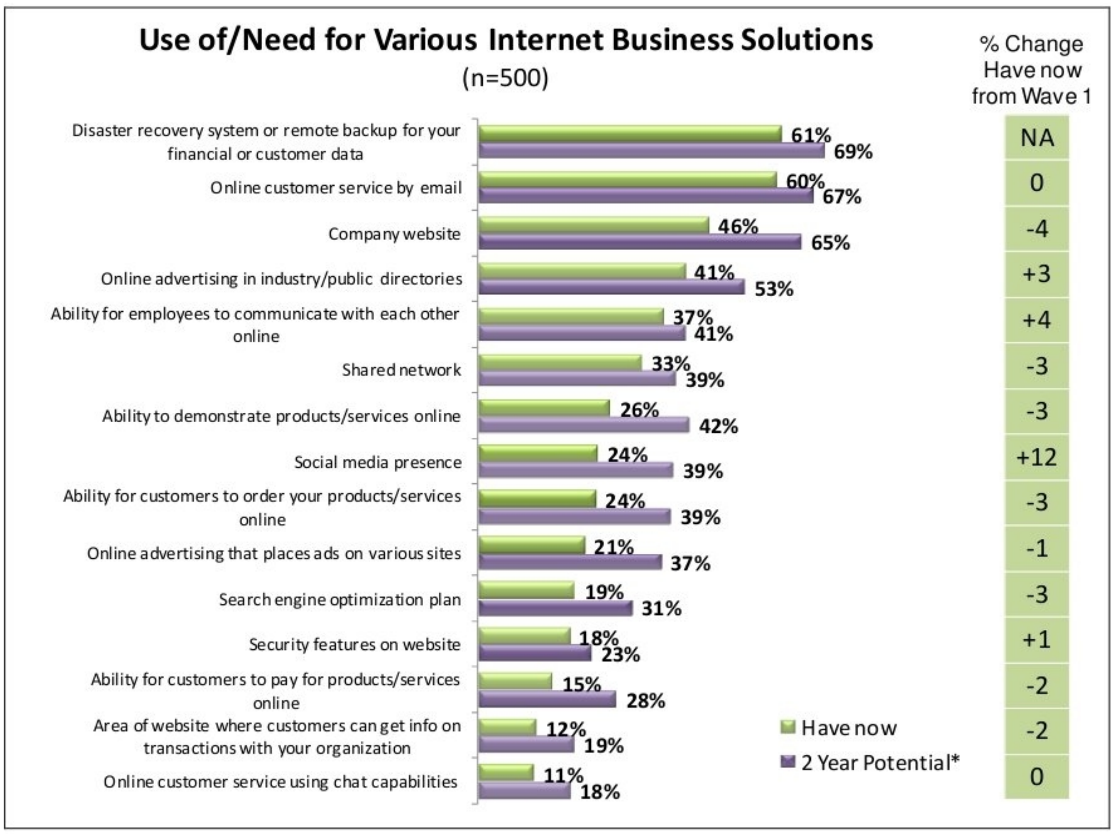


*Rated 8 to 10 on a 0 to 10 scale, where 10 = completely successful.

The SBSI tracks the adoption of 15 internet business solutions that help businesses market their brand, service their customers and run more efficiently and securely. As of December 2009 (see Figure 17), the most common technologies are a disaster recovery/backup system (61 percent), email customer service (60 percent) and a company website (46 percent). Other common internet business solutions, which are used by a quarter to a third of small businesses, involve marketing, service and internal information sharing and include: ads in online directories, internal email, shared networks, an ability to demonstrate products online, a social media presence (e.g., FaceBook or LinkedIn page), and online ordering of services.

In the past 12 months, the incidence of most technologies has not changed by more than 4 percentage points, with the exception of a social media presence, which doubled from 12 percent to 24 percent in just a year (a statistically significant change). Social media use by businesses is a major growth area that is discussed in greater detail later in this section.

For the remainder of technologies, there has been a slight retrenchment over the past year, with the incidence of use dropping slightly for eight technologies, and increasing slightly for three others. While the incidence of many technologies grew by summer and dropped by December, there have been no statistically significant changes over a year except for social media. The factor behind the drop for some technologies is most likely the economy and its effects on infrastructure. For example, many small businesses may have been forced to change locations or move from an external office to a home office, an explanation that is supported by an observed increase in home offices. Small businesses may also have been forced to cut back on technology expenses and discontinue some services, such as requiring customers to order in a store or by phone instead of at the website. Even so, small businesses did increase the use of advertising in online directories and internal email over the past year. Figure 17

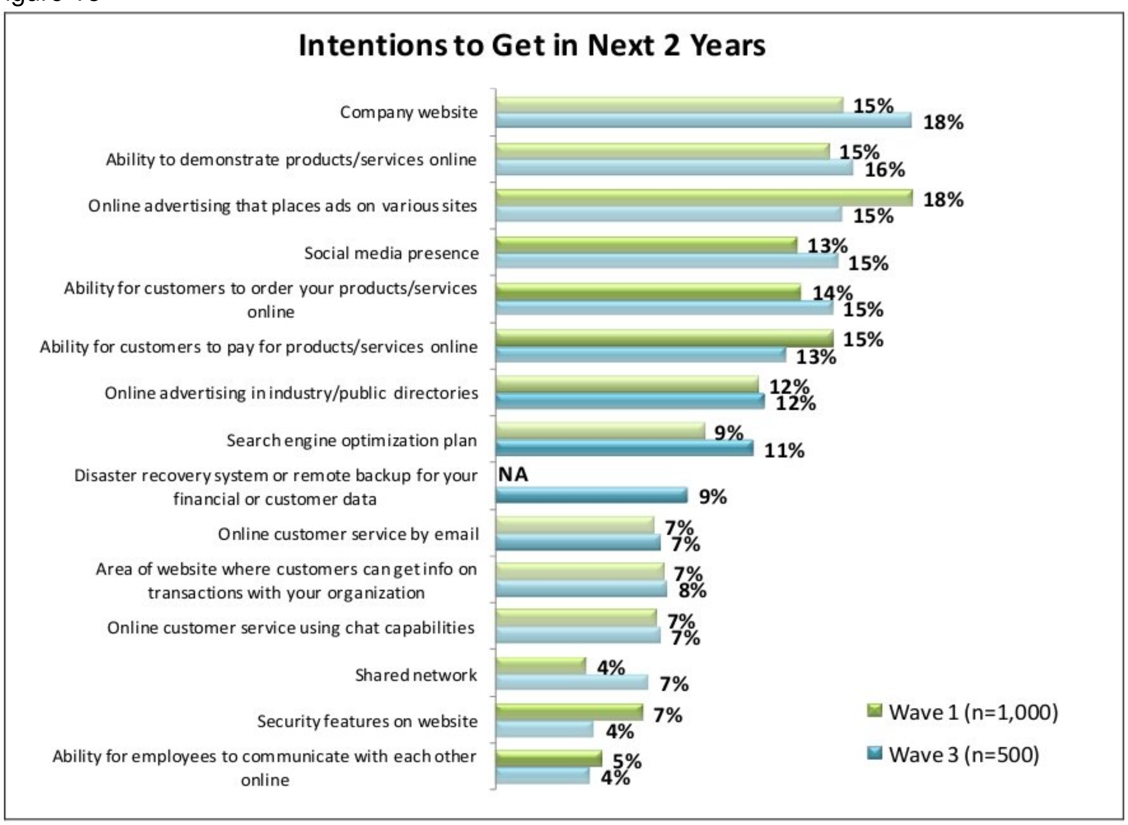


*Includes those who have now plus those planning to within 2 years.

Figure 17 above also shows the long range potential of the various technologies. After taking into account current ownership plus intentions over the next two years, it is likely that by the end of 2011, two-thirds of small businesses will have disaster recovery systems, online customer service and a website.

What are the fastest growing technologies among small businesses? Based on intention (see Figure 18), the fastest growing will be company websites, which may include companies that are putting sites back up as well as those who are putting up their first sites. After websites, the fastest growing internet business solutions will be those that help sell the small businesses' products and services, including: online product demonstrations, online advertising, social media, ability to order online, ability to pay online, and online directories. The areas with the least growth, based on intentions, will be internal security features and company email.

Figure 18



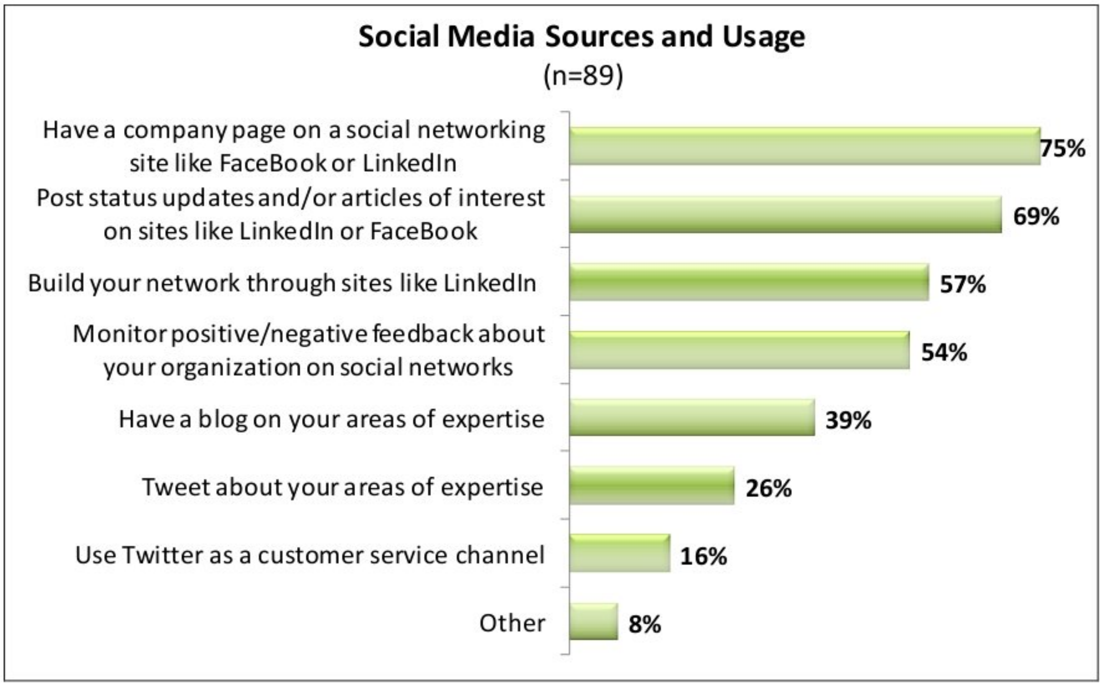
Past reports for this study noted that there is a positive correlation between the number of technologies used by a business and the success of the business based on the SBSI. In-depth analysis showed that the relationship holds even for businesses with under 5 employees, meaning the correlation with success is not just an outcome of larger small businesses with bigger budgets owning more technology. The relationship between technology and competitive success moderated in the summer at the bottom of the recession, but strengthened by December. For example, 28 percent of “tech-powered” small businesses that have 6 or more technologies are “highly competitive,” while only 19 percent of businesses with 2 to 5 technologies and 18 percent of businesses with zero or one technology are “highly competitive”.

Social Media Use by Small Businesses

A fifth of small business owners (18 percent) actively use social media such as FaceBook, LinkedIn, Twitter and blogs for their business. These owners provided additional detail on how they use social media, how well it meets expectations, and whether it pays for itself financially. In sum, they report that social media is time consuming, but offers benefits in building customer relationships. Its use is marginally profitable, but owners expect a bigger payoff in the future.

Social media constitutes a range of applications (see Figure 19), but the most common ones are a company page on a social networking site like FaceBook (75 percent) and posting status updates or articles of interest on social networking sites (69 percent). Other applications include building a network on a site like LinkedIn, monitoring feedback about the organization on social media sites, and maintaining a blog. Only a quarter of those using social media use Twitter for external communications, and a sixth use Twitter as a service channel. The bulk of these applications would not cost a business much money, but as revealed later, they can be time consuming.

Figure 19

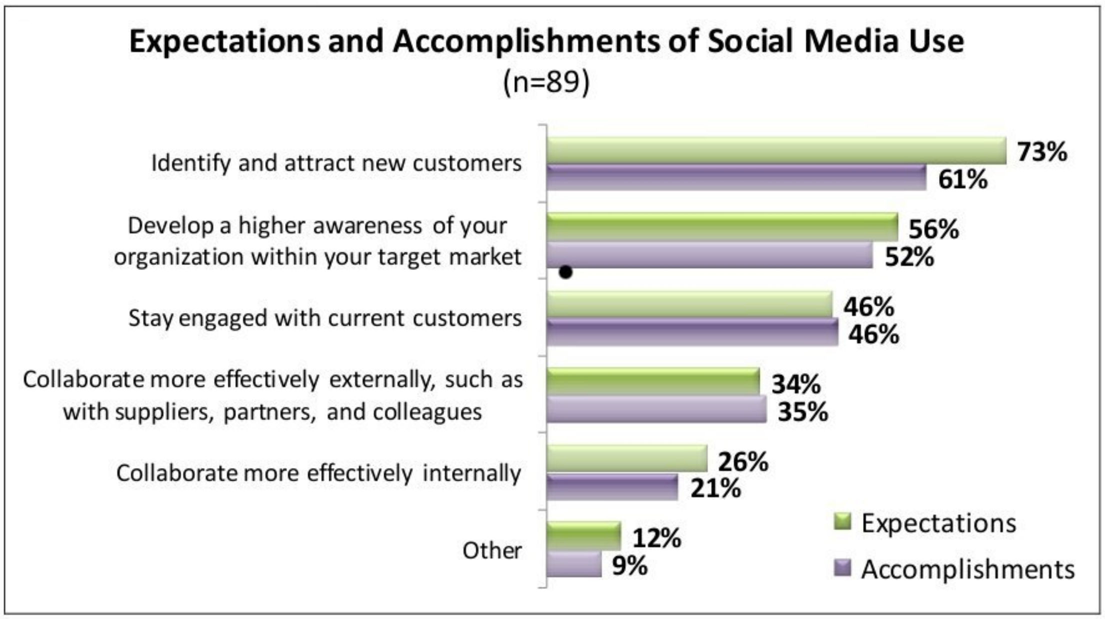


Most users of social media – 58 percent – find the medium just "met expectations" for success. For the remainder, twice as many feel the medium fell short of expectations (26 percent) than exceeded expectations (12 percent) for success.

The expectations small business owners have for social media are related to external marketing and engagement, and include identifying and attracting new customers, building brand awareness, and staying engaged with customers. Fewer small business owners expect social media to help them with collaborating with external suppliers, partners and colleagues or with staff internally. The external marketing is an obvious use of social media, but there may be a vast untapped potential for using the medium to link members of the supply network, colleagues and staff to gain advantages in creativity and productivity. Such internal uses are harder to imagine and in their infancy, but have the potential to unleash a vast reservoir of creativity and joint problem solving as social media users grow exponentially. Examples of such uses are developing a new product or service, finding low cost resources, teaming to pursue business opportunities, or leveraging an expert source to solve a special problem.

The areas that users have been successful in are generally the same as expectations. However, there is one notable gap: while 73 percent of users expect to identify and attract new customers with social media, only 61 percent have accomplished this successfully. Thus, social media performance is below expectations in bringing new business in the door, although it meets expectations for building brand awareness and staying engaged with customers.

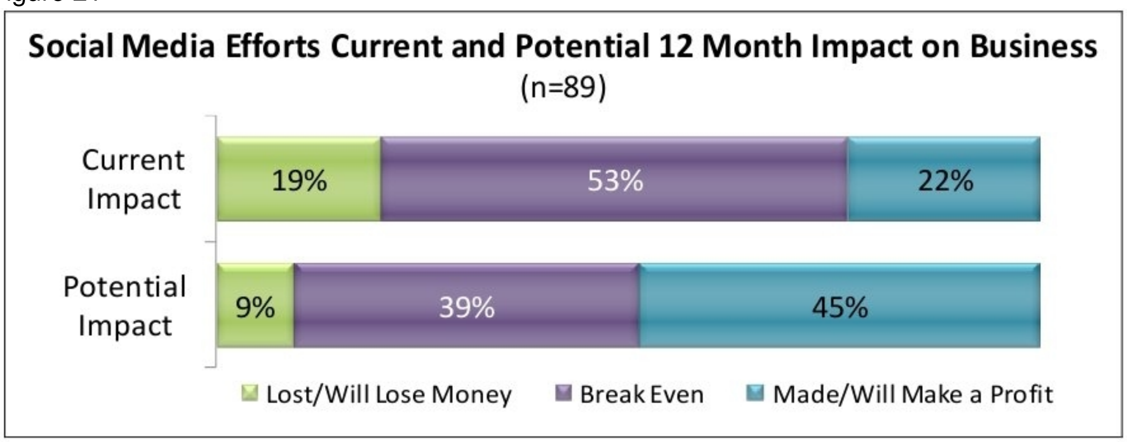
Figure 20



Social media use is not without problems, the main one being the amount of time involved. Half (50 percent) of small business users of social media have found that it has taken up more time than they expected. A common concern about social media in a business context is that it gives people a chance to criticize the business on the internet, but only 17 percent cite this as a concern. Related to this, only 6 percent feel that social media use has hurt the image of the business more than helped it. Overall, these users are able to control the medium, but are finding that it takes a lot of effort to maintain and contribute content, interact, and monitor information on social media sites.

How do social media efforts affect the bottom line for small businesses? Looking back to the past year (see Figure 21), slightly more feel they made a profit (22 percent) than lost money as a result of using social media. The outlook for the next 12 months is more positive – 45 percent expect to make a profit from using social media, while only 9 percent expect to lose money. The cost benefit is hard to measure and is subjective, but by and large, small businesses feel the medium is breaking even now but will yield a positive return. It is likely that small business owners are continually learning to use the medium more effectively, while they have gotten over the initial costs of setting up and learning.

Figure 21



Compliance

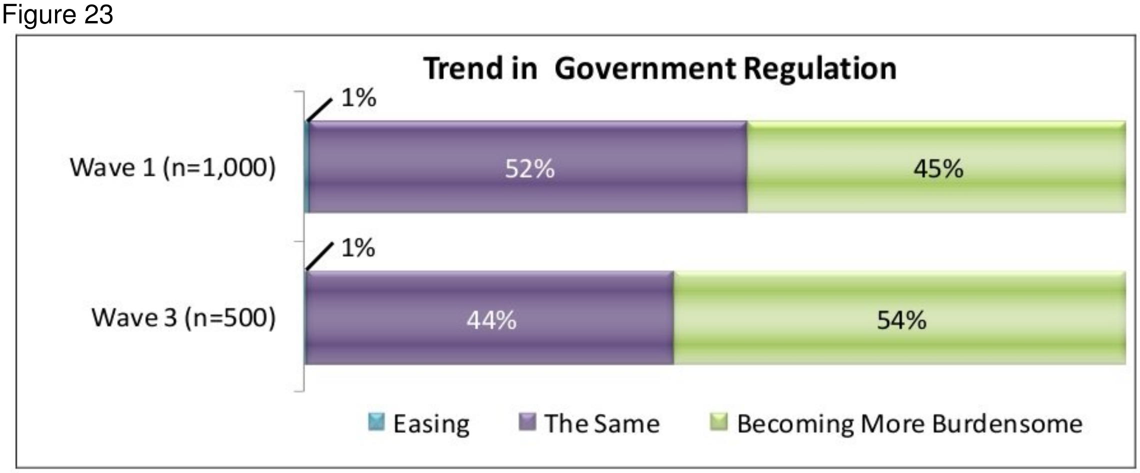
Small businesses are generally successful in the area of compliance, including complying with laws and regulations, keeping customer information secure, and keeping up with laws and regulations (see Figure 22). The perceived level of success has not changed much in the past 12 months.

Figure 22

*Rated 8 to 10 on a 0 to 10 scale, where 10 = completely successful.

Even though compliance is not a problem area, Figure 23 reveals that 54 percent of owners feel that government regulation is becoming more burdensome. This sentiment has also grown in the past year, raising the question of why small businesses have these concerns. One possible explanation for the perception of increasing burdens may be the economy and how it affects the behavior of governments. Local, state and federal agencies may be becoming more stringent in the enforcement of fines and seeking new ways to tax small businesses in an effort to make up for their own revenue shortfall. One example is real estate assessments, an area where local governments are often accused of exaggerating values when they need to raise revenue.

Figure 23



Success in Meeting Business Goals and Owner Satisfaction

A question many small business owners may wonder in the midst of a downturn is whether it is "worth it" (see next section on economy). A first look into the answer is the degree of success small business owners are having in achieving 10 broad business goals that are also statistically related to the SBSI (see Figure 24). In the past year, success has not changed significantly on any goal area, and this may not change until the general economy changes as well. The only goal area where the majority of small businesses are successful is in minimizing costs, while almost half are successful in reducing risks. Performance is mediocre in meeting goals related to increasing value, producing a decent income, maintaining an attractive lifestyle, and growing the numbers for the business. The goal area with the worst performance overall is in growing the business as fast as the owner desires – almost as many are failing in this area (28 percent) as succeeding (32 percent), and success has worsened from a year ago. Another problem area is in building wealth for the owners – 26 percent are failing compared to 32 percent succeeding.

Figure 24

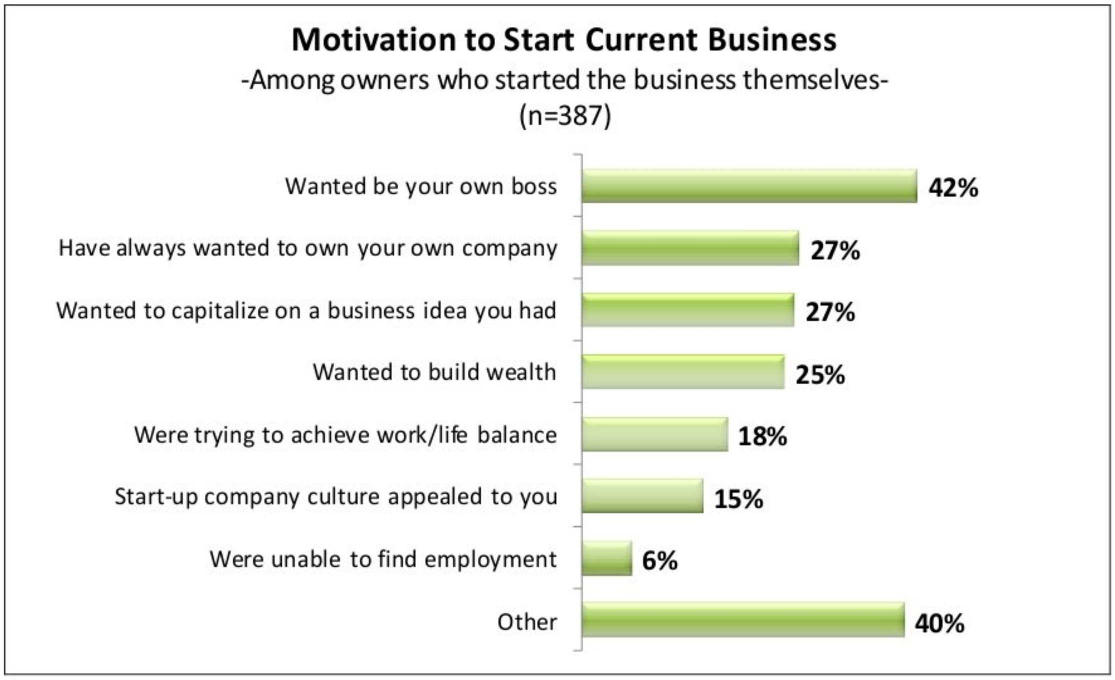
*This goal was not applicable to 17% of SB owners; therefore "Don't Know/Refused" were removed from the sample for this item.

Another question is whether small business owners are generally satisfied with their occupation (see Figure 25). The majority – 60 percent – are highly satisfied with "being a business owner" compared to only 7 percent who are dissatisfied. The level of satisfaction dropped from 6 months ago when this question was first asked, but the change is not significant. Hard times may be testing the resolve of small business owners, but most are still happy with what they do.

Figure 25

A total of 80 percent of small business owners were the original founders of their concern. The major reason for starting the business was a desire to be one's own boss (see Figure 26). Only 6 percent started a small business because they were unable to find employment. Other reasons instead were related to a desire to be a business owner, capitalizing on an idea, and a desire to build wealth. Many mentioned an "other" reason for starting up their own business, which includes dissatisfaction in previous job, enjoyment or passion for what they do, being laid off, retired and needed something else to do, and saw an opportunity.

Figure 26

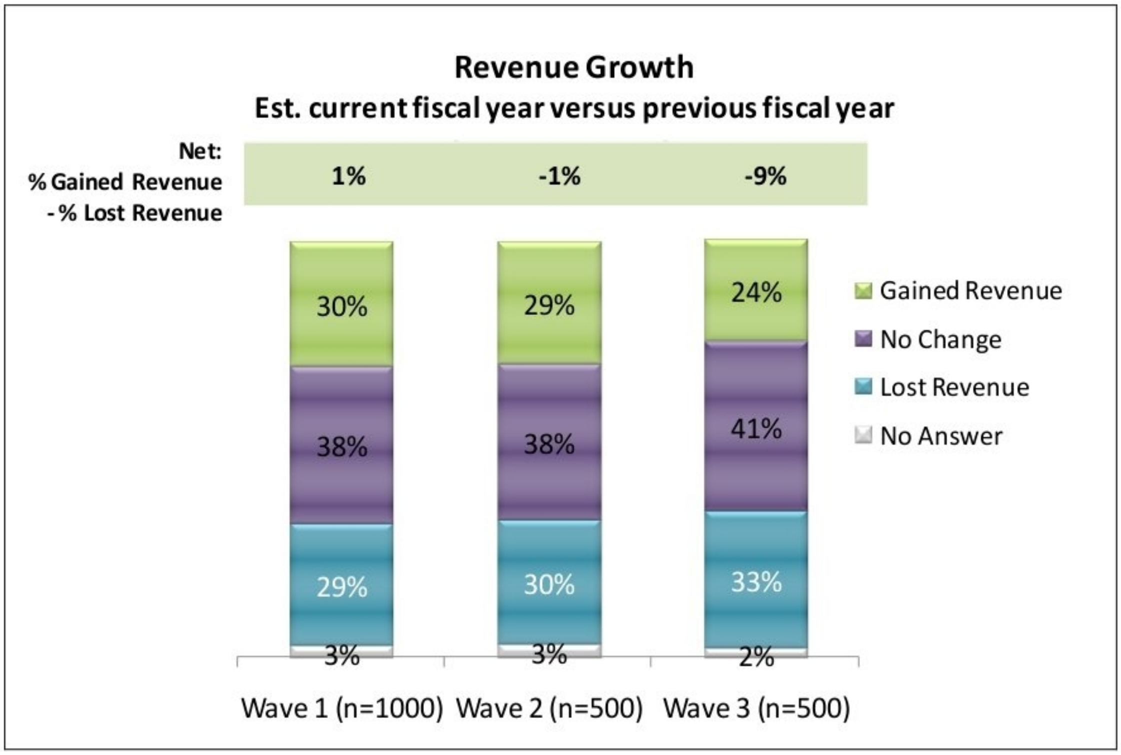


Small Business Financial Success

Based on revenue and profit projections, the majority of small businesses are in a stable position, though there is downward trend due to the recession. When comparing expected sales for 2009 with the year before, 24 percent of small businesses expect an increase in revenue, 33 percent expect a decline, and 41 percent expect no change from last year (see Figure 27). Due to the economic environment, more small businesses lost revenue than gained.

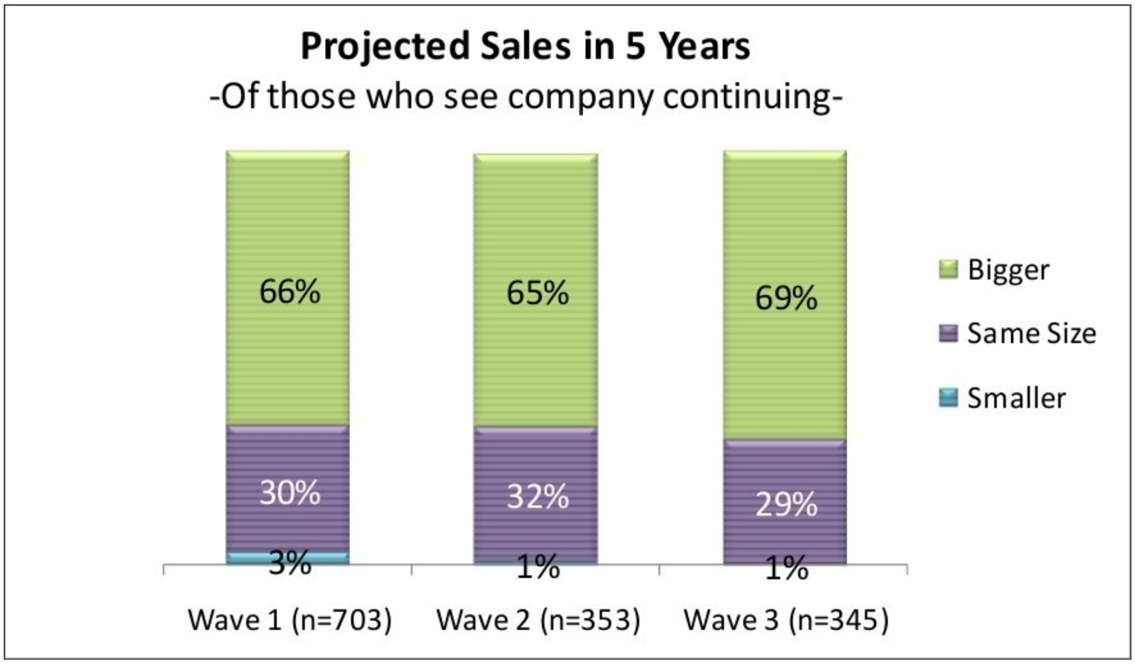
The situation is worse than the growth trend from 2007 to 2008; a year ago (December/January 2009 wave), 30 percent of small businesses projected that they had increased sales over the previous year while almost an equal number (29 percent) projected they had decreased. If 2009 proves to be the bottom of the downturn, the future prognosis is for positive growth as the economy bounces back.

Figure 27



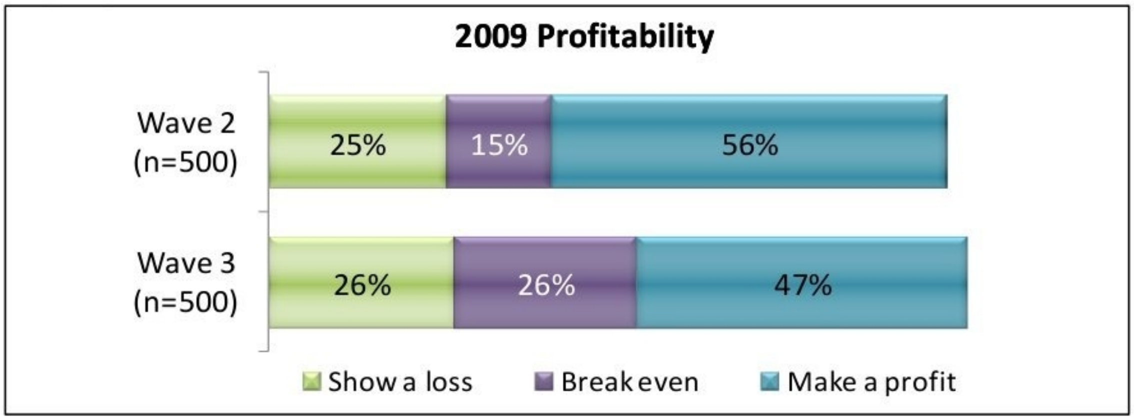
The majority of small businesses expect to be around in five years, although 26 percent do not due to a variety of reasons that can viewed as positive (retirement, sale for a profit, mergers) or negative (closing down due to financial stress, sale for a loss). Those that expect to continue operating expect to be bigger (see Figure 28), with 69 percent expecting higher revenues and only 1 percent expecting lower revenues. Long run revenue expectations have not changed over the year.

Figure 28



Slightly less than half of small businesses (47 percent) project a profit for 2009, while a quarter of them (26 percent) expect to lose money (see Figure 29). In June, 56 percent of small businesses indicated that they had made a profit for their most "recent fiscal year," which for most would be 2008. Moving from 2008 to 2009, more small businesses are moving from being profitable to just breaking even.

Figure 29

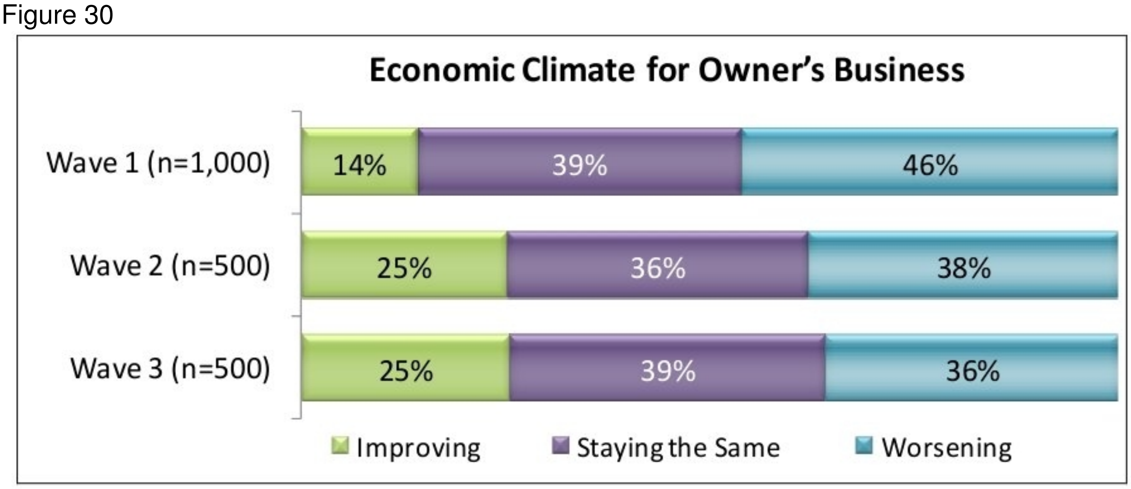


The Small Business Economic Climate

The current recession, which is the longest since the Great Depression, is clearly having an impact on small businesses. The impact has continued to spread over the past three waves of the SBSI (Dec/Jan 2009, June, and December) and small businesses are being forced to take harsher measures to weather the downturn.

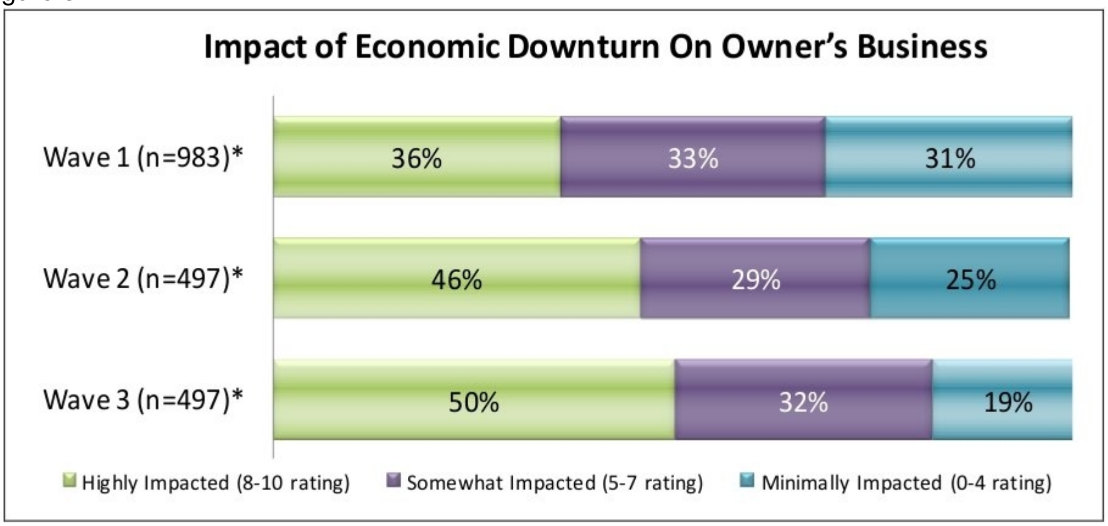
The general view of the economic climate grew more pessimistic from the start of 2009 to June (see Figure 30). Since June, the economic view has been stable. As of December, more small businesses feel the climate is "worsening" (36 percent) than "improving" (25 percent).

Figure 30



Another measure of the economy is the perceived impact the recession has had on small businesses. The impact has steadily increased over the past three waves, while decreasing numbers of small businesses believe that impact has been minimal (see Figure 31). Half of small businesses – 50 percent – believe the downturn has had a high impact on their business, compared to just 36 percent a year ago. As of December, only 19 percent of small businesses were minimally impacted, compared to 31 percent a year ago. Fully four out of five small businesses have now been impacted more than minimally by the recession.

Figure 31



*Note: Non-response not included in sample.

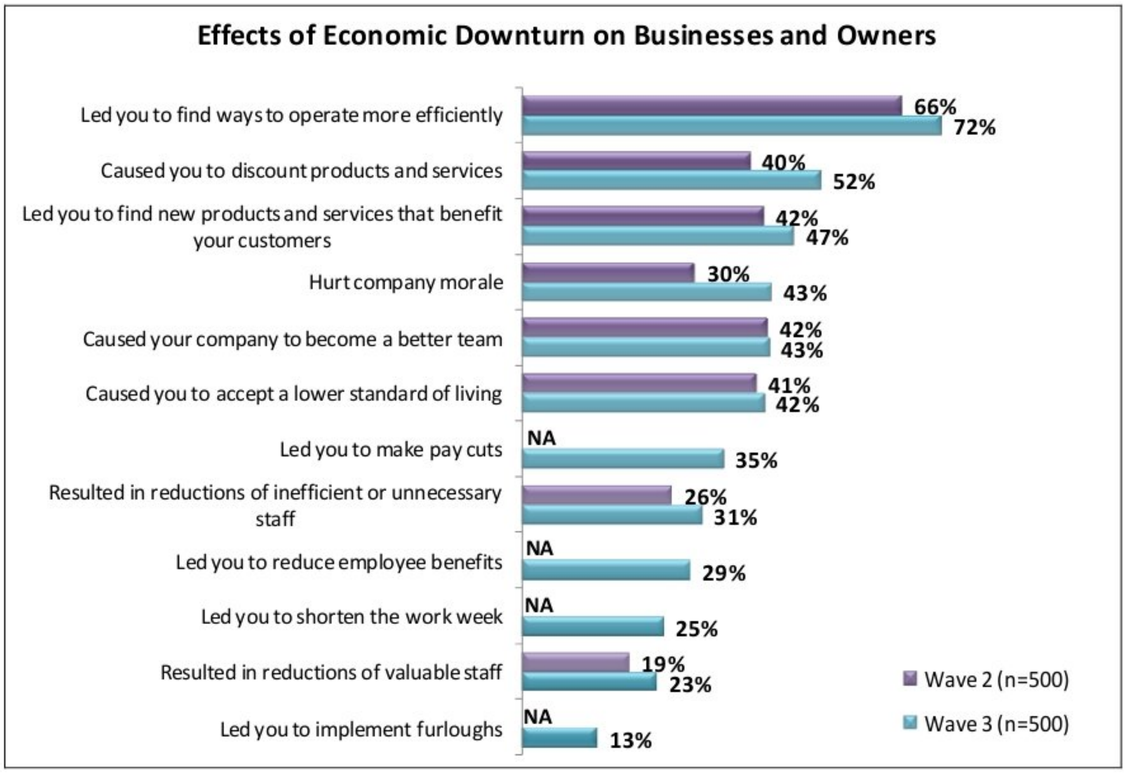
The recession’s effects on small businesses have been expanding over the past six months, although not all impacts are necessarily bad. As shown in Figure 32, which lists the ways the recession has affected small businesses as of June and December, a few good things have happened:

- As of December, 72 percent have found ways to operate more efficiently (up significantly from 66 percent in June)
- 47 percent have been led to find new products and services that benefit customers
- As hard times force people to work together, 43 percent have become better teams
- 31 percent have reduced inefficient or unnecessary staff by December

The recession has also led to some negative effects, some of which have increased over time. As of December, 52 percent have had to discount products and services, a significant increase over June when only 40 percent had done so. Such discounting is probably a natural outcome as the recession reaches its worst stage. Unfortunately, analysis of the SBSI has shown that firms that engage in such behavior are less successful. Deep discounting to win sales can worsen the financial situation of a business, create problems delivering services, and diminish the perceptions of quality.

Another negative effect is worsening morale within the company. A full 43 percent of small businesses experienced this effect, up significantly from 30 percent in June. It appears that as the recession has lingered, it has begun to test the resolve of owners and staff.

Figure 32

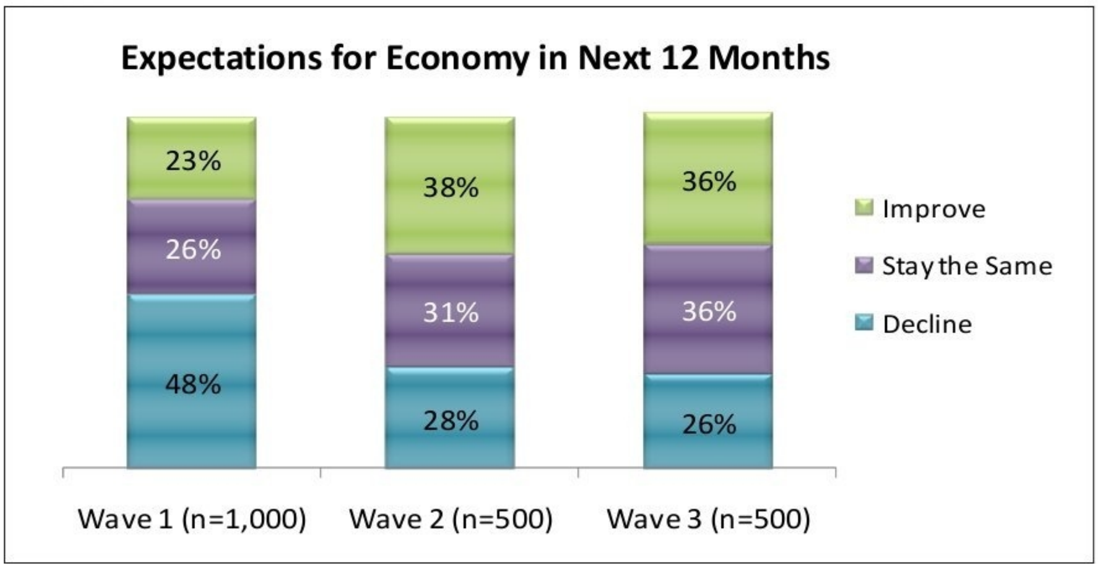


The downturn has affected small businesses in a variety of other ways, but to a lesser degree than those mentioned. As a result of the recession, owners have to do the following as of December:

- Accept a lower standard of living (42 percent)
- Make pay cuts (35 percent)
- Reduce employee benefits (29 percent)
- Shorten the work week (25 percent)
- Reduce valuable staff (23 percent)
- Implement furloughs (13 percent).

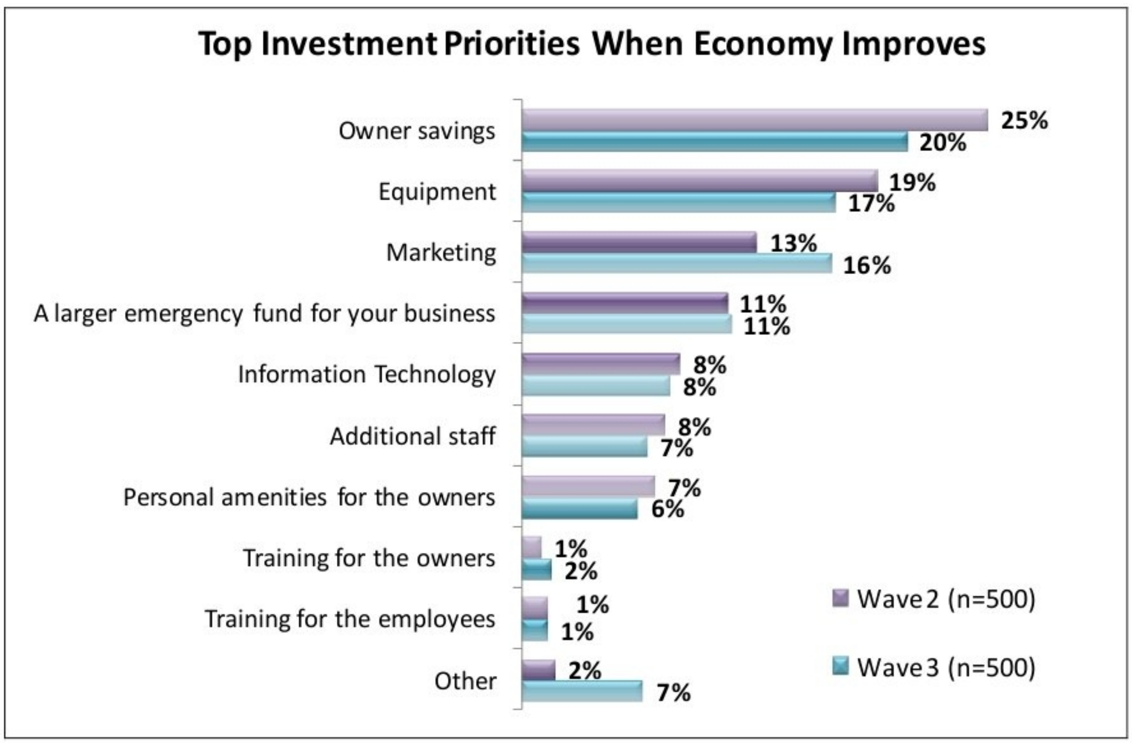
Against the backdrop of a rising impact of the economy, the outlook for the year ahead is more positive (see Figure 33). As of December, more small business owners expect the economy to improve in the next 12 months (36 percent) than to decline (26 percent). Looking at the trends, small business owners got much more pessimistic over the first 6 months of 2009, while their optimism has not changed over the second half of the year. Hopefully, in the next wave, expectations will start to shift to being more positive and counterproductive behaviors such as cutting prices and valuable staff will stop growing.

Figure 33



A final observation is how small businesses plan to invest when the economy improves (see Figure 34). The most common “top priority” is to replenish owner savings (20 percent will do so). This is not surprising because so many owners have had to cut their own pay and tap their savings to finance their enterprises. Other priorities include new equipment, marketing, building emergency funds for the business, and information technology. A number mentioned an “other” priority, which includes paying down existing debt, building the business for the future, and acquiring land/buildings (perhaps to take advantage of low prices).

Figure 34



Note: owners were asked to provide just one answer, the “top priority.” The categories included were a pre-coded list which was derived from open-ended responses to a similar question in Wave 1.

The Small Business Owners and their Businesses

What do small businesses in America look like? 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. The definition of a small business will vary from source to source. In the SBSI, a small business is defined as either having a payroll and/or providing 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" is defined as having fewer than 100 employees. There are about 6 million small businesses in the U.S. that have a payroll and under 100 employees.

The Small Business. For the first time, the SBSI Survey examines the global reach of small businesses, revealing an interesting story about how the sector may be helping to counteract the trade deficit that the U.S. has with other countries. As background, in the most recent SBSI wave, 33 percent of small businesses believe their industry is becoming more global, compared to only 5 percent who think it is becoming less so. Yet, the trade area for most small businesses is mostly local; 62 percent of small businesses report that the bulk of their business/customers comes from the local metro area, 14 percent from a multiple state/metro region, 14 percent from the nation, and 10 percent from multiple countries.

It is interesting that one out of ten small businesses trade predominantly with customers outside the U.S., but the global reach is even greater. A full 19 percent of small businesses sell goods or services to customers in other countries. Small businesses are less likely to import, with only 11 percent reporting they buy or procure goods or services outside the U.S. Only 2 percent have employees outside the U.S. Summing it up, America's small businesses are twice as likely to export goods and services as they are to import. These customers may be buyers from overseas or South America, or they may be customers closer to home including the extensive cross-board trade with Canada and Mexico.

The study provides an up to date profile on the typical small business. Not much has changed since the last survey wave; the typical small business has a single owner, operates within a local area, has a single location, and has sales in the low six figures. A profile is as follows:

- 31 percent have just one employee (the owner), and the median number of employees is 3
- 49 percent are home based, and the number has steadily risen over the past three waves, possibly due to the effects of the recession
- On average, small businesses have 1.6 owners; 59 percent have a single owner, 31 percent have two owners, and 10 percent have 3 or more owners
- 13 percent are minority-owned
- 30 percent are women-owned (over 50 percent of the business is owned by women)
- 86 percent have just a single location
- The median age of small businesses is 15 years, and 22 percent have operated 5 years or less
- Over a third of small businesses are just getting started:
  - 5 percent are start-ups and 35 percent are early growth businesses
  - 47 percent are considered mature businesses
  - 10 percent are in various phases of closing or being sold or transferred
- The median annual revenue is $182,700; among those reporting their sales, 43 percent gross less than $125,000.

The Small Business Owner. 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 is older, more likely to be male, highly experienced, and relatively affluent. The following is a summary of owner traits quantified in this study:

- Small Business owners are slightly older than the U.S. population; 76 percent are at least 45 years of age, and 16 percent are 65 years or older
- 70 percent are male and 30 percent are female
- Over half have a college education, but not all:
  - 19 percent have only a high-school degree and 3 percent have less than a high school degree
  - 32 percent have attended trade school, have some college, or a two year degree
  - 45 percent have at least a four year college degree

- Owners have considerable industry experience; 60 percent have worked in their industry for 20 or more years
- 80 percent of owners started the business, and 48 percent of the founders have started more than one business
- 82 percent work in their business full-time
- Among those willing to share the information about their annual income, 43 percent earn at least $100,000 per year.

Who are the most competitive small businesses? Competitiveness correlates with characteristics of the business and the owner, but the success factors may change over time due to economic circumstances. For instance, in the last wave, factors such as having multiple owners, gender, and education were related to small business success, but these factors are less important or even vanished as predictors of business success. Some of the factors that track with competitive success (and a few that are not currently important) are shown in Figure 35. One driver of small business success remains consistently strong: the phase of the business. Over half (57 percent) of "highly competitive" small businesses are mature concerns, while almost half (47 percent) of "failing" businesses are in the start-up or early growth phase. The mature enterprises, with their established customer base, have the clear advantage in the current economic environment.

Company size is also a success factor for small businesses. For instance, "highly competitive" small businesses have a higher percentage of businesses with 10 or more employees and have median revenue three times greater than "failing" businesses. The less successful enterprises are also more likely to be home based, although it could be financial problems that led to the business attaining this status.

In the last SBSI wave, demographics seemed to matter, but now that the recession has spread to four out of five small businesses, the relationships are not as strong. The more competitive small businesses tend to have a higher share of owners who are at least 45 years of age.

Figure 35

Characteristics of Small Businesses and their Owners by Level of SBSI Competitiveness				
	Highly Competitive (n=99)	**Marginally Competitive** (n=172)	**Marginally Failing** (n=124)	**Failing** (n=97)
Business Characteristics				
Multiple owners in Business	36%	44%	38%	38%
Women-owned Business	23%	32%	35%	31%
Minority Owned Business	10%	14%	13%	13%
Start-up or Early Growth Business	31%	40%	44%	47%
Mature Business	57%	50%	43%	34%
10 or more employees	17%	18%	9%	2%
Median Annual Revenue ($000)	$312	$195	$163	$117
Home-based business	41%	49%	46%	59%
Owner Characteristics				
Owner is College Graduate	48%	48%	41%	45%
Owner is 45 Years or Older	81%	77%	70%	73%
Owner is <45 Years Old	15%	22%	26%	26%
Owner is female	27%	34%	31%	26%

About the Small Business Success Survey

The baseline (Wave 1) for the Small Business Success Survey was conducted in December 2008 through January 2009. A total of 1,000 small business owners were interviewed by telephone. A second wave (Wave 2) was conducted in June 2009 among 500 small-business owners. The third wave (Wave 3), which is reported here, was conducted in December 2009. Small businesses included in the study were privately owned (not publicly traded), for-profit, had fewer than 100 employees, and had 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, and tracks trends in Small Business Success over time. These are the results from the third wave of data collection.

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

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