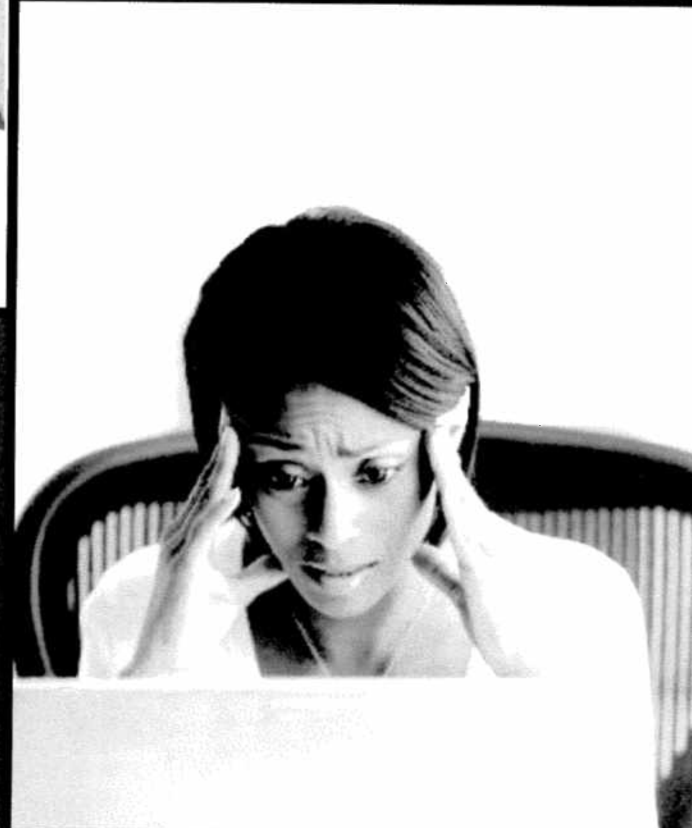
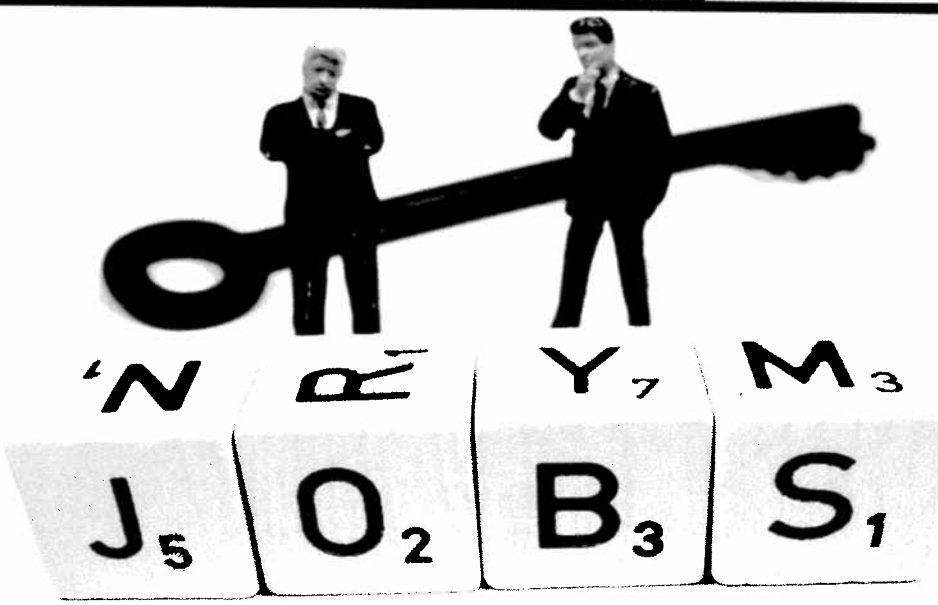
# 2010 Mid-Year Economic Report

NSBA

National Small Business Association®





## Small-Business Financing

As NSBA repeatedly has said over the last two years, small-business access to capital is a growing problem. When asked what are the most significant challenges facing their business, nearly one-third (29 percent) said lack of available capital—that's up from 24 percent just six months ago.

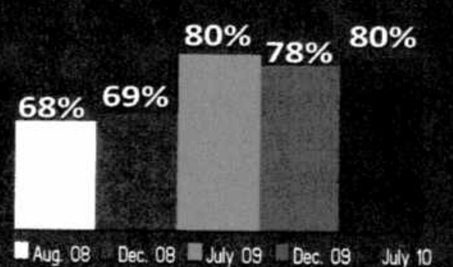
The prospect of getting financed for a small business—even in a growing economy—is very difficult simply due to the fact that many small businesses lack the assets necessary for a traditional bank loan, making them a riskier lending option for banks. Unfortunately, the number of small businesses able to obtain adequate financing for their business has steadily decreased in the last few years. Today, only 59 percent of small businesses are able to obtain adequate financing for their business. That number has dropped from 78 percent in August 2008, 67 percent in December 2008, 62 percent in July 2009, and 61 percent in December 2009. Although a majority are able to secure financing, it cannot be glossed over that 41 percent—which translates into more than 12 million—of the nation's small businesses are not able to get adequate financing.

NSBA has been asking small-business owners if their business had been impacted by the credit crunch since early 2008. In February 2008, 55 percent responded that it had. In August 2008 that number jumped to 67 percent, and continued to rise to 69 percent in December 2008 and hit a high of 80 percent in July 2009. Despite a slight easing in December 2009 down to 78 percent, the number today is back up at its highest point. Eighty percent—four out of five—of small-business owners report that their company has been impacted by the credit crunch.

What types of financing has your company used within the past 12 months to meet your capital needs?

| | Aug. 08 | Dec. 08 | July 09 | Dec. 09 | July 10 |
|---|---|---|---|---|---|
| Bank loan | [illegible] | 44% | 53% | 46% | 43% |
| Earnings of the business | [illegible] | 51% | 43% | [illegible] | 42% |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Used no financing | 17% | 22% | 16% | 21% | 21% |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Private loan (friends or family) | 12% | 16% | 20% | 18% | 19% |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Other (please specify) | 8% | 8% | 6% | 7% | 7% |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |
| Private placement of debt | 2% | [illegible] | 3% | 2% | 4% |
| [illegible] | [illegible] | [illegible] | [illegible] | [illegible] | [illegible] |

Small-business owners reporting being impacted by the credit-crunch.




The availability of capital is a critical component to business growth and job creation for small businesses. Since 1993, when NSBA began asking these questions, there has been a direct correlation between access to capital and job growth—when capital flows more freely, small businesses add new jobs.

Among small-business owners for whom capital availability has been a problem, 44 percent state that they have been unable to grow or expand the business, and 20 percent state that they have been forced to reduce their number of employees. Perhaps even more worrisome is the growth in small businesses that report they are unable to increase inventory to meet demand—up from seven percent in December 2009 to 12 percent today. This means that, although growth opportunities exist for these businesses, they are being held back by a lack of capital.

In the last six months, there has been a decrease in small-business use of nearly every financing mechanism, from traditional bank loans to credit cards to vendor credit. The number of small businesses using no financing options remained steady at 21 percent—virtually no change from the December 2009 results.

Prior to the December 2009 survey, credit cards had been the number one source of financing for small-business owners, Today, however, they have dropped to the number three slot, just behind traditional bank loans at number one and earnings of the business at number two. Although reports have shown a higher rate of approvals among credit card applicants, many small businesses are hesitant to take on credit-card debt given the volatility associated with them.

### Loans

While the number of small businesses relying on traditional bank loans jumped to 53 percent in July 2009—up from 44 percent in December 2008—only 43 percent small-business owners today are using bank loans. That number was higher just six months ago with 46 percent of small-business owners using bank loans. In addition to banks' unwillingness to loan to small businesses, the fact that terms continue to worsen for small businesses is likely part of the reason small-business owners have been seeking fewer bank loans. Twenty-four percent of small-business owners reported less favorable terms on their loans in the last year, and only two percent report that the terms of their loans have become more favorable.

Although lower demand for loans from small-business owners who are typically hesitant to take on additional debt in a distressed economy may be a part of the equation, the decrease in loans is more likely related to the terms and availability of such loans. Many banks appear unable or unwilling to lend affordable capital to any small businesses that doesn't meet their extremely high definition of a "creditworthy" small business.

Underscoring this fact, the April 2010 Federal Reserve Board (the Fed) Senior Loan Officer Survey reported that, although banks have begun slightly easing standards on large firm loans, little has changed for small firms. Among large banks, 19.4 percent eased their standards on loans to large firms while only 3.4 percent did the same for small business. Compounding matters, there was even a net tightening on loan terms to small businesses from smaller banks—the very banks that small businesses typically turn to as they are the last remaining institutions still willing to make character-based loans. The reason cited for this tightening was completely unrelated to the businesses themselves, and rather was due to a less favorable economic outlook and the banks' decreased tolerance for risk.

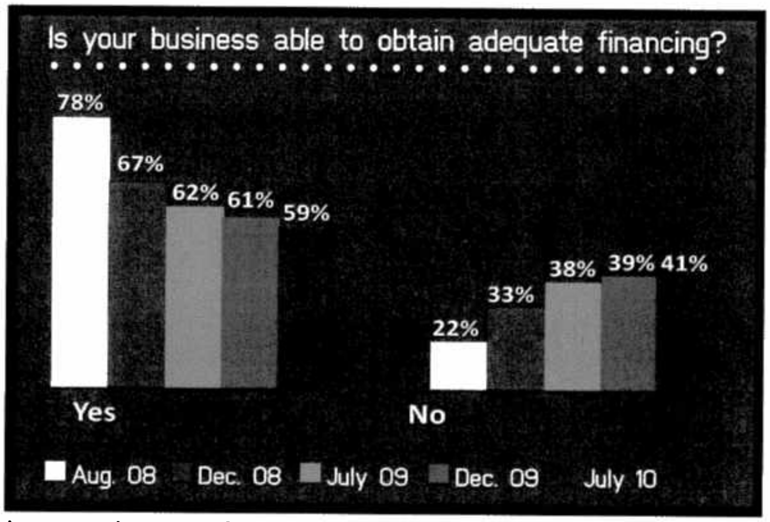
The implications of the collapsed housing market continue to haunt the small-business community. In August 2008, 12 percent of small-business owners leveraged their business loans with a second home mortgage. That number has been steadily decreasing since that time and is now at an all-time low of six percent.

## Credit Cards

Given the events of the last year, in which interest rates on credit cards remained high, credit-card limits were arbitrarily cut, and credit-card accounts were eliminated entirely by the credit-card companies, it is not surprising that the gradual decrease in credit-card usage has continued. Although the number of small-businesses relying on credit cards has dropped slightly, they still account for one of the largest sources of financing for NSBA's members.

In the last year, a major piece of legislation was passed, the Credit CARD Act, which went into effect in early-2010 and put a stop to some of the most egregious practices of the credit-card industry. Unfortunately that legislation didn't expressly include the cards used exclusively or primarily for small-business use despite the best efforts of NSBA and some key advocates on Capitol Hill. Credit-card companies and large banks railed against the legislation and an amendment to extend the protections to small businesses, warning that the legislation and the small-business inclusion amendment would make credit cards wildly more expensive and difficult to qualify for across the board.

Now four months after the implementation date, that simply has not happened. Granted, a significant number of small businesses (48 percent) report that the terms on their credit cards have in fact gotten worse in the last several months, however that number actually decreased since the December 2009 report when 64 percent reported worsening terms in recent months. Given that many banks have voluntarily adjusted their standard operating procedures to extend the legislative protections to both personal and business credit cards, this is a clear indication that the legislation did NOT cause wholesale cost increases in credit cards as opponents to the bill projected. Furthermore, the survey indicates that the law is working, as fewer small-business owners reported that the terms of their credit card had worsened.




The interest rates small-business owners are subject to continue to be high, though not as a direct result of the legislation. The average interest rate small businesses pay is 16 percent. Half of small businesses (50 percent) pay more than 15 percent in interest rates on their credit cards. Nearly one-quarter (23 percent) of all small-business owners are currently paying 20 percent or more in interest rates. This has not been a notable change since the December 2009 report.

One particularly problematic trend that began in late-2008 was credit-card companies arbitrarily reducing the credit limit on a card—or shutting down the card entirely. For a small-business owner carrying a balance, this unexpected reduction results in a diminished credit score, as the owner suddenly is utilizing more of his/her available credit. With banks increasingly reliant on personal credit scores in their underwriting practices, this credit score hit can be quite problematic. Compounding matters, these reductions are typically due simply to the fact that, as a small business, they are viewed as a more risky credit option.

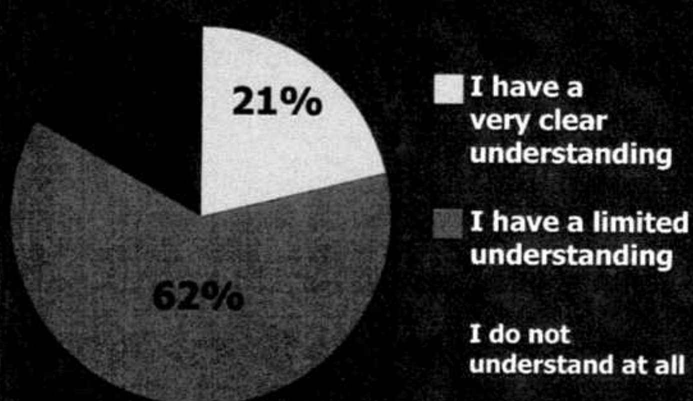
When asked in December 2008, 28 percent of small-business owners responded that they had experienced a decrease in their line(s) of credit or a credit-card limit in the past six months. Today, 36 percent—up slightly from 35 percent in December 2009—of small-business owners were subject to such a decrease in the last six months.

> "There is a direct correlation between access to capital and job growth. Unless small-business owners are able to secure financing, we will continue to see high unemployment."

**Which one of the following issues do you believe Congress and President Obama's administration should address first?**

| | July 10 | Dec. 09 |
|---|---|---|
| Reducing the tax burden | 36% | 43% |
| Increase small business access to capital | 23% | 18% |
| Reducing the regulatory burden on businesses | 14% | 15% |
| Health care reform | 10% | 7% |
| Rising fuel prices and addressing the nations' dependence on oil | 3% | 4% |
| Credit card reform | 3% | 3% |
| Improving education to provide a qualified domestic workforce | 1% | 1% |

**How well would you say you understand how the new health care reform law is going to impact your business?**




## Public Policy

Just months away from the mid-term elections with some key pieces of legislation having been passed—health care reform and financial regulatory reform to name a few—lawmakers find themselves still facing high unemployment and a struggling small-business community. Despite all the rhetoric about the importance of small business to the U.S. economy, too little has been done address the many issues bogging down America's small-business owners. Small business has played a critical role in past economic recoveries; however they continue to be hit with increasing difficulty accessing capital, putting the brakes on any growth opportunities.

Small-business owners continue to rank "reducing the tax burden" as the top issue Congress and the administration should address. However in the last six months, there was a notable drop from 43 percent to 36 percent among those that ranked taxes their top issue. In that same time, the number of small businesses that ranked "access to capital" as the top issue Congress and the administration should address rose 5 points to 23 percent. Reducing the regulatory burden on small businesses and health care reform came in third and fourth, respectively.

### Health Care Reform

Despite the passage of broad health care reform—legislation which NSBA ultimately opposed due to its inability to truly address rising costs—small business owners continue to report dire consequences of rising health insurance costs. When asked how they have coped with rising health care costs, 24 percent, up from 20 percent in December 2009, were forced to reduce their workforce. That means one in four small businesses, in this terrible economy with high unemployment, is having to lay-off workers due to health insurance costs.

There exists a significant amount of confusion among small-business owners about how the new health care law will impact their business. When asked if their business will qualify for the small-business health care tax credit, only 10 percent said yes. The majority—52 percent—said they weren't sure whether or not they were eligible for the tax credit. In more broad terms, small businesses were asked to rate their understanding of the new law, and only 21 percent said they have a clear understanding while 79 percent said they have a limited or no understanding at all of how their business will be impacted. Given that this survey is among

What are the three most significant challenges to the future growth and survival of your business?

| | |
|---|---|
| ECONOMIC UNCERTAINTY | 73% |
| DECLINE IN CUSTOMER SPENDING | 47% |
| COST OF HEALTH INSURANCE | 37% |
| FEDERAL TAXES | 36% |
| LACK OF AVAILABLE CAPITAL | 29% |
| REGULATORY BURDENS | 28% |
| STATE AND LOCAL TAXES | 22% |
| FOREIGN COMPETITION | 10% |
| COST OF EMPLOYEE SALARIES | 8% |
| LACK OF QUALIFIED WORKERS | 8% |
| COST OF EMPLOYEE BENEFITS, NOT INCLUDING HEALTH INSURANCE | 7% |
| COST OF TECHNOLOGY | 5% |
| NO MAJOR CHALLENGES | 1% |

## CONCLUSION

Small employers comprise 99.7 percent of all employer firms in the U.S. One in two workers in the private workforce run or work for a small business, and one in four individuals in the total U.S. population is part of the small business community (equaling 23 percent of the population.) Firms with fewer than 500 employees accounted for 64 percent of net new jobs between 1993 and the third quarter of 2008. Thirty-two percent of those gains came from the creation of new, small firms.

According to the Pew Research Center, small businesses are widely seen as having a positive impact on the country. Small business ranked number one with 71 percent of respondents having positive views. Large corporations, on the other hand, earned a 64 percent negative rating. Just 25 percent say the federal government has a positive effect on the way things are going in the country and banks and other financial institutions only earned a 22 percent positive rating.

According to SBA's Small Business Economic Indicators for 2003, when the economy gained momentum after the previous downturn in the early 1990s, firms with fewer than 500 employees increased their net employment in the first year after the recession, while large firms continued to shrink. From March 2000 to March 2001, small firms added 1.15 million net new jobs while large firms lost 0.15 million net new jobs.

NSBA believes more can, and must be done to ensure entrepreneurship remains a viable, attainable option for every American.

**Amid all the financial concerns small-business owners face, the fact that Congress would approve this new, massively burdensome 1099 reporting requirement is unfathomable.**