

AFTER A YEAR OF CHANGE

The 2001 Small Business Environmental Scan

Executive Summary

Introduction

The time since the last Environmental Scan has been a period of tremendous change. Whether each of these individual changes is long-lasting remains to be seen. However, in aggregate, they serve as a reminder of the fluctuating cycles in which small businesses exist and the changing circumstances to which they must respond.

The Dot-Com Collapse. A great deal of energy and resources was invested in the creation of the dot-coms. Many critical inputs were channeled into that sector of the economy. Their collapse had many ramifications for small business, forcing a more rapid examination by small firms regarding their ability to adapt to the changing technology.

A New and Short-Lived Energy Crisis. The ups and downs in the energy market created problems for small businesses. Although most small firms developed stop-gap measures over the last year to deal with sharp fluctuations, the greatest lesson was the new awareness of the cyclical nature of the energy market and the marked impact it can have on entrepreneurial activity and growth.

In addition, small business can learn much from this cycle, including the need to make adjustments in operations, processes and management to sustain the fluctuations. Investment in efficient plants and equipment, implementing efficiency practices, optimizing energy purchases and budgeting for contingencies can smooth out the peaks and valleys in this vital marketplace.

The Business Cycle. Many of the concerns expressed by small business in recent years had to do with the era of expansion the entire economy was experiencing. Now, in a time of downturn, the concerns have fluctuated and are centered around shrinking markets and falling prices. This emphasizes the need for small companies to be prepared with contingency strategies for both sides of the economic cycle.

Terror, War and National Emergency. The entire small business community has been affected by the events of late 2001 either in disrupted supply chains, lost consumer confidence, fluctuations in financial markets or destruction. Although it is generally accepted that these changes will be temporary, their effect reinforces the need for small businesses to be aware of potential vulnerabilities and to plan and develop processes accordingly.

Small firms are urged to re-examine their risk management strategies, their data system integrity, the robustness and redundancy of their supply chain and their employee safety and health procedures.

Regulation

- Concern with regulation seems to have lessened in the past year, probably because of preoccupation with other key environmental factors: energy, economic slowdown and the war against terrorism.
- Small businesses still absorb a disproportionate share of the regulatory cost burden, particularly in the areas of environmental regulation and tax preparation.
- A lack of understanding of regulatory issues continues to plague small businesses, particularly in the non-professional service sector.
- Streamlining in federal procurement practices may cut some small businesses out of the federal procurement markets.

Workforce

- Tightness in the labor market continues to be a major small business concern with the majority of companies reporting problems in hiring and retaining quality employees. More small firms are examining creative retention strategies, and more owners and managers are working longer hours to compensate for deficiencies in employee skill base.
- The high mobility of talented personnel has become a major issue for small companies, particularly those in high-growth Internet-related firms.
- The workforce is becoming increasingly more diverse, but there is not a corresponding interest in diversity-related training among small business.
- More companies are offering health insurance in an effort to attract and retain talented employees. In addition, many firms are offering a wider array of informal benefits, including the option to telecommute, pursue personal growth opportunities and become more entrepreneurial within the firm.
- Employee management and training continue to be key concerns for small companies, with the greatest needs in the areas of managerial or supervisory skills and computer literacy and applications.
- Small firms do not invest much in training programs because of the inability to formalize programs, the difficulty in accessing qualified trainers and the lack of time to develop programs internally.
- Strategies to deal with the training deficiencies may lie in the creation of training consortia or the provision of e-learning opportunities.

E-Commerce/E-Business

- More than 80 percent of small businesses employ some form of IT in their companies. Spending in this area continues to increase among smaller firms.
- IT in most small firms is limited to communication and business-to-individual transactions. More companies have opportunities to engage in such transactions, which would in turn create another opportunity in the marketplace for more small companies to offer Internet-related services and products to support e-commerce strategies.
- It is expected that mini-dots – small business engaged in dot-com enterprises -- will experience a tremendous growth in the near future.
- A good number of firms are still struggling with how to incorporate the Internet into their existing businesses. Although the majority is attempting to facilitate this integration, it is driven more by the desire to streamline processes than it is by customer demand.
- Internet adoption by small business is hindered by a variety of factors including taxation issues, privacy and security issues, intellectual property and fraud concerns and legal and contracting issues.
- The most common tactical errors made by small firms entering the Internet arena are failure to centralize conversion authority, unengaged management, poor vendor selection, imposing the same standards and structure as off-line exchanges, inappropriate rewards systems, benchmarking against off-line competition, inadequate training and a focus on internal needs rather than customer expectations.
- Although the collapse of the dot-coms has focused the Internet-related activity more in the areas of providing support for traditional small businesses, interest in Internet-based firms continues. The second generation of dot-coms seems to be more focused on helping other firms conduct e-commerce than in overthrowing existing markets themselves.

Business Ownership

- Because of the aging of Baby Boomers, issues surrounding family business and transition have gained in importance.
- 60 percent of the U.S. GDP is generated by family business. Assistance efforts should be focused in this area rather than on attracting large firms.

Rural Small Business

- Establishments with 20 or fewer employees constitute 75 percent of rural businesses.
- Small, rural firms generally offer employees a wider range of job responsibilities than larger firms, fill leadership roles in the community and are seen as a key source of creativity and ingenuity that fuel future entrepreneurial growth companies.

- Rural entrepreneurship is challenged by a less developed infrastructure – both physical and virtual; the need for larger pools of highly skilled labor and the resources to offer employees high wages, better benefits and job training; and the shrinkage of locally available capital, due to major consolidations in the banking industry.

Value Chain/Supply Chain

- Small businesses constitute the numerical majority of businesses in any supply chain, up to 80 percent by some estimates.
- Periods of economic downturn present both opportunities and threats to small businesses in the supply chain. Reduced revenues, demands for greater efficiencies and local plant closings may squeeze some suppliers out of the supply chain. On the other hand, small firms have greater flexibility, product specialization, personal relationships, quick local response times, specialized technical knowledge, readily available inventory, in-depth product knowledge, and skills in problem-solving that give them an advantage in responding to supply chain demands.
- A digital divide exists between large and small firms in the supply chain. Past integration efforts have focused on huge EDI systems. However, more web-based systems are being developed that are within reach of smaller firms and allow for more efficient joint management of inventory, suppliers, customers and finances.

Access to Capital

- Lending to small businesses is down currently, and start-ups and new ventures appear to be the least attractive to lenders. Light manufacturing and distribution businesses still have some appeal.
- Traditional lending through commercial banks continues to dominate small business. Equity financing is down.
- Overall limited access seems to be in response to the downturn in the economy after several years of expansion; however, structural changes in the lending community may pose the greatest threat to small businesses.
- Although it is often believed that bank consolidation is creating a banking community distanced from local needs, small businesses seem to be benefiting from larger bank conglomerates' intensive marketing to small business.
- Venture capital and non-traditional sources of equity capital are playing a key role, especially in IT firms. Owners of high technology firms are not educated on the array of investment options available to them. However, demands and expectations among angel and venture capital investors are higher than in years past.

Strategy/Management

- The lack of planning and strategy development within small business continues to be of concern to providers of small business assistance. However, a strong correlation exists between business success and the presence of clearly defined plan for the business.
- Likewise, there is a strong correlation between business success and the presence of competitive intelligence in the company. On the contrary, business owners who believe that they have all the competitive intelligence they need to personally manage the business do not enjoy similar success.
- Most small firms lack any formal mechanism for collecting, assimilating and converting competitiveness information into knowledge that is useful for strategy formation. One exception is the area of family-owned businesses, which tend to have a more sophisticated planning process in place and tend to share information about performance and expectations more readily with their employees.
- One study found that successful family firms are typified by the following: a strong market focus, planning, rigorous employee selection and training programs, understanding of key processes, a corporate culture that rewards behaviors that support the company's strategy, frequent or constant communication and adequate measurement of key processes with feedback mechanisms.

Outsourcing

- Outsourcing continues to offer two opportunities to small businesses – to be the recipients of outsourcing from larger firms and to outsource critical business functions themselves, particularly in the application service providers (ASPs) and business process outsourcing (BPOs) areas. ASPs are found to be an attractive alternative to hiring and supporting an expensive IT department within large firms.
- Use of BPOs – payroll, benefits, accounting and legal services – allows companies to focus on their core competencies and enhance competitiveness.

Self-Employment

- Income differences among male and female self-employed workers continue to dominate this issue among small businesses. The disparity is partially attributable to the types of businesses women start compared to those started by men. Women tend to start less lucrative retail and service firms, while men concentrate their efforts in the professional services and construction areas.
- Other factors that influence the compensation factor include time devoted to child-rearing activities, availability of capital and management experience.
- One study found that the availability of insurance for the self-employed is an enabler of entrepreneurship. More universally available coverage would encourage more self-employment.