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1996 Small Business Survey

from the

Private Companies Practice Section

American Institute of CPAs

October 1996

EXECUTIVE SUMMARY

In its sixth survey of small business owners conducted in June 1996, the Private Companies Practice Section (PCPS) of the American Institute of CPAs found that:

Outlook: Optimistic — Small business owners are optimistic about this year's revenues: 60% expect 1996 revenues to rise compared to 1995, page 3.

Coastal Differences — Economies of the states surveyed are thriving, with conditions in California looking the most rosy and those in New York looking the least, page 4.

"Cinderella Cities" — Orlando, Austin, San Jose, Chicago and Rochester top the list of cities cited as poised for economic growth, page 4.

Tax Overhaul Favored — Support swells for tax reform and a national sales tax. More than three-quarters (76.0%) of the respondents favor broad tax reform while roughly one in three (34.8%) endorse a national sales tax. Respondents also predict little effect to their businesses from a minimum wage increase, page 5.

Workplace Changes — Employee benefits and personnel policies are undergoing radical transformation. More than one in four respondents instituted major changes in these areas during the past two years, and more than 50% enhanced their health coverage, page 7.

Employee Retirement — While more than half the respondents believe employers have a responsibility to sponsor retirement savings plans for their employees, only one in four (27.5%) actually does so, page 9.

Support for Liability Reform — The majority of respondents strongly support federal and state legal liability reform. Aspects of reform deemed most important to respondents are punitive damages and replacement of joint and several liability with proportionate liability, page 11.

Liability Price Tag — Exposure to legal liability has climbed over the past several years. This year, 61% said their exposure had increased, compared to 56% in 1994 and 57% in 1993. More than two in five say the current litigious environment has hurt their business, page 12.

Disclosure Overload — Financial disclosure poses a cost burden for smaller companies, page 14.

CPAs as Advisors — Small business owners rely on CPAs more than other professionals or family members when making important business decisions, page 15.

Bank Traffic — Borrowing sags among small business owners: only slightly more than one in three respondents (37.6%) borrowed in the past 12 months, page 16.

SURVEY METHODOLOGY AND RESPONSE

The Private Companies Practice Section (PCPS) is a voluntary association of approximately 7,700 local and regional CPA firms that primarily serve private companies. It is part of the American Institute of CPAs (AICPA), the national professional organization of CPAs with more than 328,000 members in public practice, business and industry, government and education. This sixth Small Business Survey is one example of how PCPS monitors key financial and management issues affecting privately held companies.

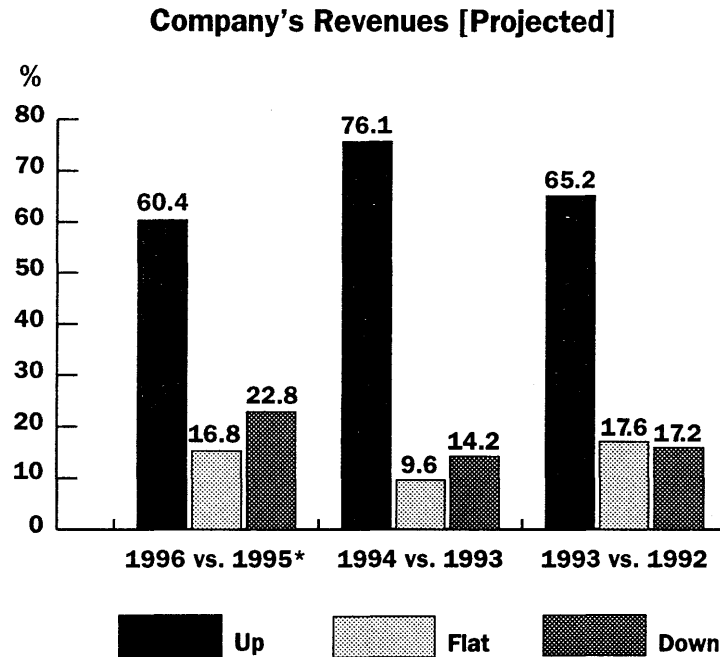
During the first week of May 1996, PCPS mailed a survey (attached) to approximately 2,000 business owners in each of five states: California, Florida, Illinois, New York and Texas. "Small businesses" were defined as those with less than \$26 million in annual revenues. Names of the businesses and their owners were obtained from Response Media Products based in Atlanta, Georgia. By June, PCPS received 413 completed surveys.

The conclusions drawn in this report are based on the answers and comments of the survey respondents. Survey results were computer tabulated by Suburban Associates, a research data processing company in New Jersey, which has verified the survey's accuracy at plus or minus 6.5% at a 95% confidence level. When findings by state, industry or company size differ markedly from the total response, the variation is noted in the discussion of the findings.

SURVEY FINDINGS

Economic Outlook

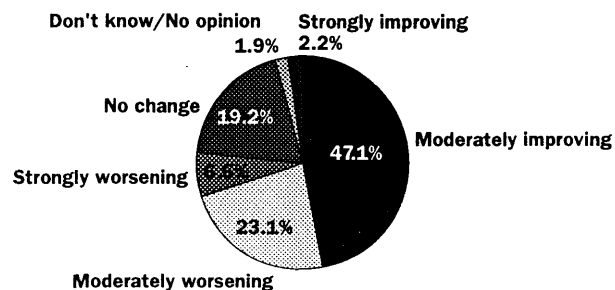
The financial outlook for the nation's small business owners remains rosy. This year, 60% of the respondents expect revenues to rise in 1996 compared to 1995[†]. As shown, however, this year's respondents are less optimistic than in prior years.



*Note: PCPS did not conduct a Small Business Survey in 1995.

Respondents enjoy strong economic conditions in their states. When asked if they thought their state economy was improving or worsening, nearly half (49.3%) said it was “strongly” or “moderately” improving.

Is Economy in Your State Improving or Worsening?



[†]1996 includes survey information gathered from five states where 1992-94 data compares all states.

Responses differed by state, however. While companies in Texas and California, in general, perceive favorable economic conditions, companies from New York are more dour.

Is Economy Improving or Worsening: By State

	CA	TX	FL	IL	NY
Strongly improving:	3.5%	4.5%	2.2%	**	**
Moderately improving:	55.8	52.3	44.6	50.7	27.9
Moderately worsening:	16.3	26.1	18.5	28.8	29.4
Strongly worsening:	8.1	8.0	6.5	1.4	7.4
No change:	14.0	9.1	25.0	17.8	32.4
Don't know/No opinion:	2.3	**	3.3	1.4	2.9

** not a category that year.

Certain metropolitan areas are poised to benefit from this economic growth over the next five years. When asked to name any city in their state that is likely to experience an economic upswing, respondents indicated the following:

Top Two Cities Poised For Growth in Next Five Years: By State

Florida:	#1 Orlando	#2 Tampa
Texas:	#1 Austin	#2 Dallas
California:	#1 San Jose	#2 Sacramento
New York:	#1 Rochester	#2 New York City
Illinois:	#1 Chicago	#2 (tied) Bloomington, Champlain, Rockford

Respondents are taking a number of steps to take advantage of the economic upswing. When asked “What steps, if any, are you taking to capitalize on the economic upturn?” nearly half of the respondents said: “paying down debt,” (48.2%), and slightly fewer are “purchasing new equipment” (39.5%). This trend follows from prior years[†], as follows:

Steps Taking to Improve Operating Results*

	1996	1994	1993
Paying down debt:	48.2%	**	39.6%
Purchasing new equipment:	39.5	53.8%	27.8
Adding new products/services:	37.9	31.2	**
Entering new markets:	34.9	39.8	42.5
Hiring new people:	34.4	58.1	24.5
Opening new facilities:	10.8	11.8	13.2
Increasing R&D:	7.2	3.2	7.5
Seeking outside investors:	0.5	**	**
Other:	2.1	5.4	12.7

*respondents were asked to select all that apply.

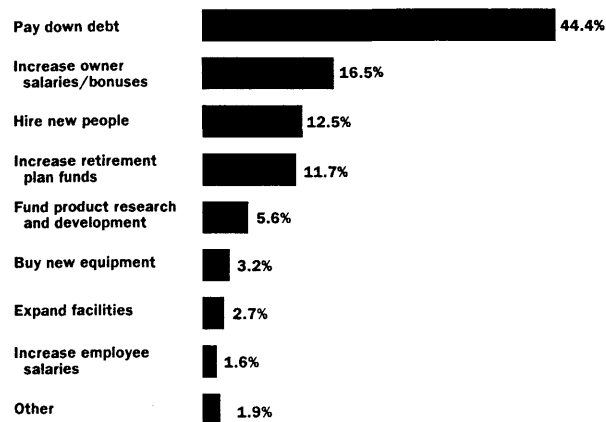
**not a category this year.

When asked what they would do with a significant profit increase, nearly half of the respondents (44.4%) would “pay down debt,” considerably ahead of the second and third-place responses, “increase owner salaries” (16.5%) and “hire new people” (12.5%). While these answers are consistent with those from previous years, “expanding new facilities,” ranked second in 1994, dropped in importance in 1996. Facilities expansion, a relatively big ticket option, has dropped in favor from second in 1994 to seventh in 1996.

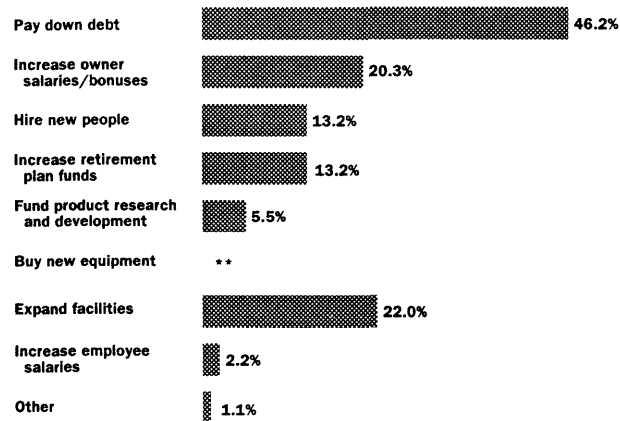
*1996 includes survey information gathered from five states where 1993–94 data compares all states.

What Would You Do With a Significant Profit Increase?*

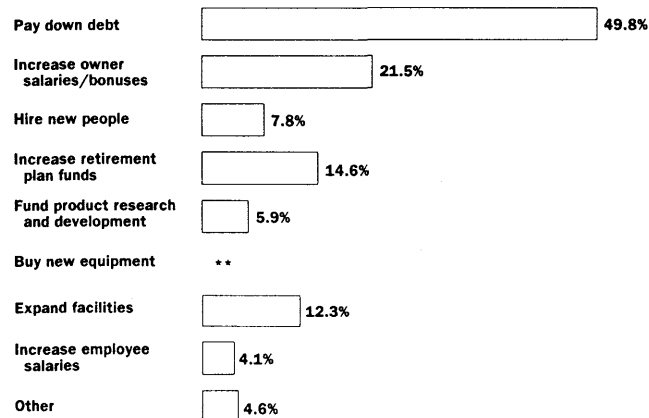
1996 survey



1994 survey



1993 survey



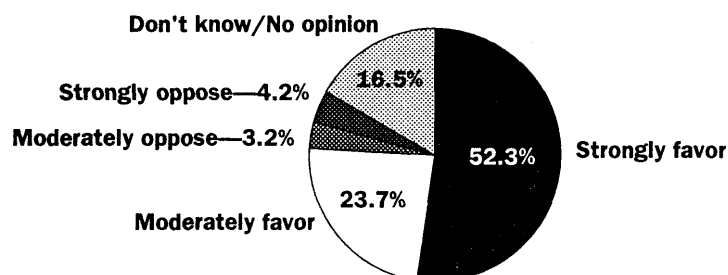
* some respondents chose more than one answer.

** not a category that year.

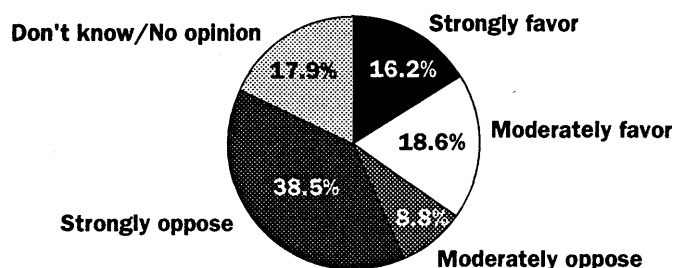
Public Policy

When it comes to public policies that affect the bottom line, small business owners advocate change. Respondents overwhelmingly favor broad tax reform: more than half (52.3%) “strongly favor” reform, and another 23.7% “moderately favor” reform. Responses are split when it comes to a national sales tax: about one in three (34.8%) support such a tax, while roughly half (47.3%) oppose it.

Do You Favor or Oppose Broad Tax Reform?

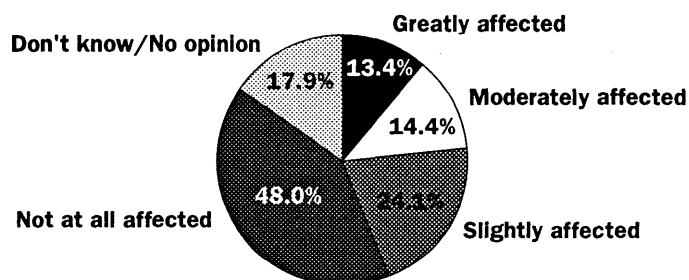


Do You Favor or Oppose a National Sales Tax?



When asked about the effect of an increased minimum wage, nearly half (48.0%) said they would not be affected at all.

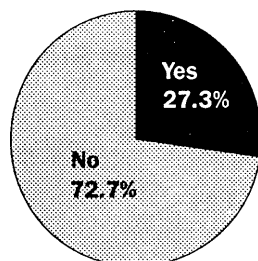
Effect of Minimum Wage Increase



Employee Benefits and the Work Environment

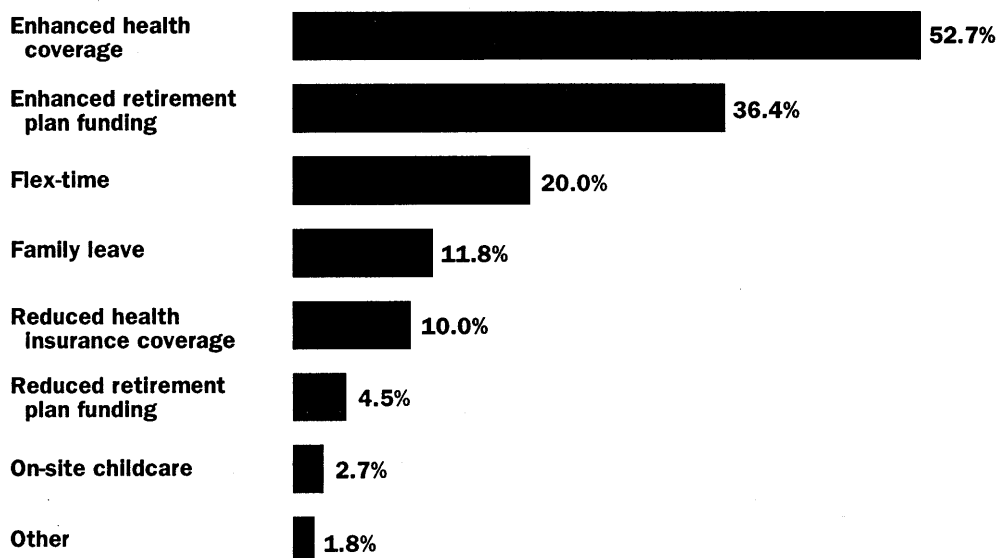
Over the past two years, more than one in four (27.3%) of respondent companies have instituted major changes in employee benefits and personnel policies.

Instituted Major Changes in Benefits or Personnel Policies?



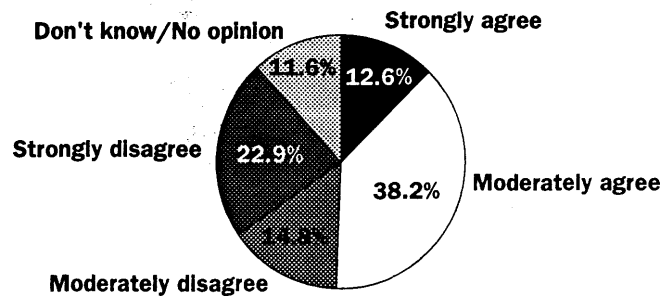
The most common changes are “enhanced health coverage,” cited by 52.7% of the respondents, followed by “enhanced retirement plan funding” (36.4%).

Kinds of Benefits or Personnel Changes



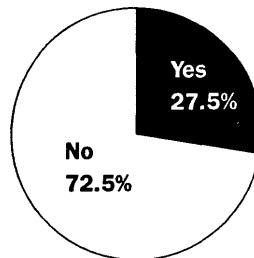
In the area of retirement planning, respondent companies clearly want to provide for the long-term financial well-being of their employees. Approximately half (50.8%) of the respondents “strongly” or “moderately” believe that “Employers have a responsibility for the future financial security of their employees to sponsor employee retirement savings plans.”

Agree or Disagree: “Employers Have a Responsibility . . . to Sponsor Employee Retirement Savings Plans”



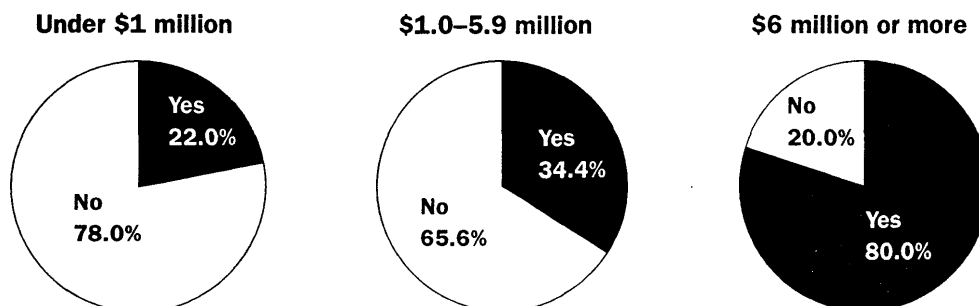
Although most believe that employers should sponsor employee retirement savings plans, however, only about one in four (27.5%) respondents actually do so.

Does Your Company Have an Employee Retirement Savings Plan?



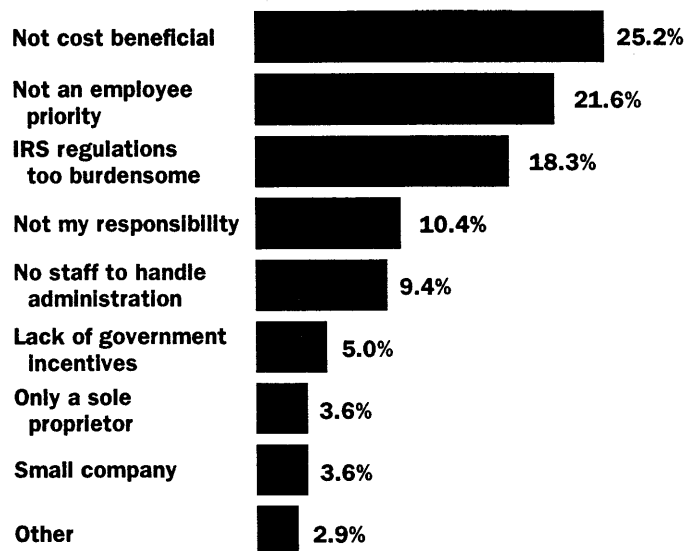
Answers varied by company size. Respondents with revenues in excess of \$6 million were four times more likely to sponsor a retirement savings plan than those companies with revenues under \$1 million.

**Sponsor Employee Retirement Savings Plan:
By Company Size**



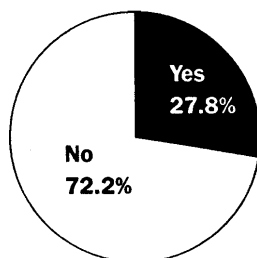
Costs pose the greatest barrier between a company's wish to offer a plan and its ability to provide one. Indeed, more than one in four respondents (25.2%) cite "not cost-effective" as the primary reason why they do not sponsor an employee retirement savings plan. Other obstacles include "not an employee priority" (21.6%) and "burdensome IRS regulations" (18.3%).

Reasons Why Company Does Not Sponsor a Retirement Plan

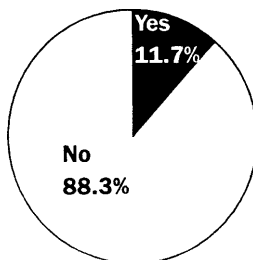


Innovative personnel policies—such as flex-time and telecommuting—are slowly taking hold in the small business community. Approximately one in four (27.8%) respondents give their employees the option of an alternate work schedule. Telecommuting is less prevalent: only about one in ten (11.7%) respondents permit this on a regular basis.

Offer Alternate Work Schedules?

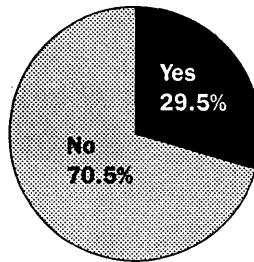


Offer Work-at-Home Option?

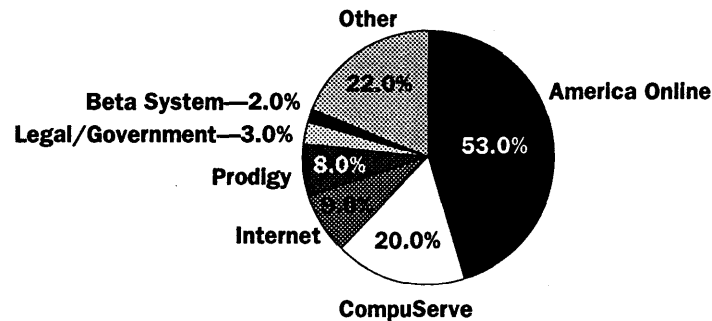


The technological revolution is also sweeping through smaller companies. Nearly one in three (29.5%) respondents subscribe to an on-line computer service, the most popular being America Online.

Subscribe to On-Line Computer Service?



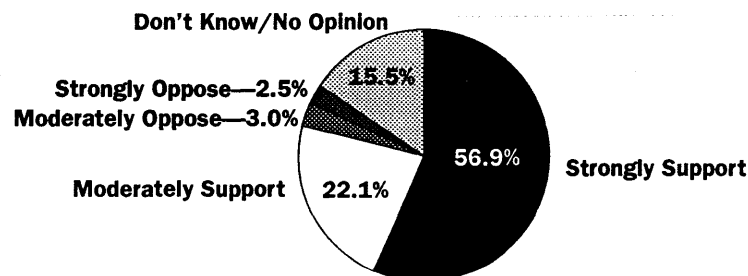
If So, Which Ones?



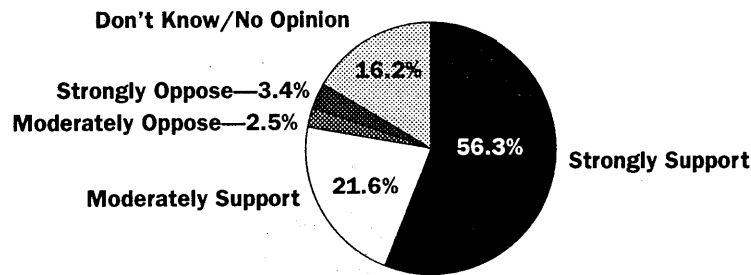
Legal Liability

Despite Congressional gains toward tort reform among publicly traded corporations, legal liability still poses an imminent threat to the nation's small business owners. More than three quarters (79.0% and 77.9%) of the respondents surveyed support reform at the state and federal levels, respectively.

To What Extent Do You Favor State Liability Reform?

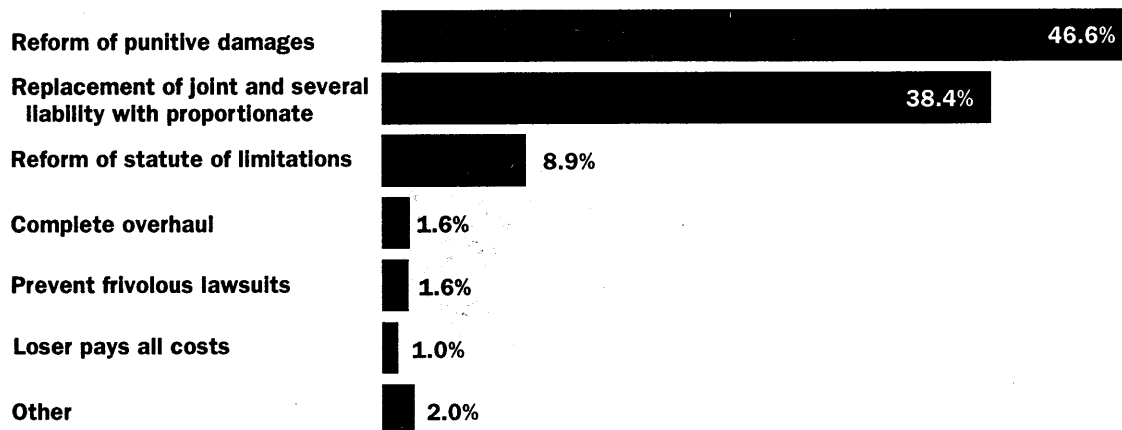


To What Extent Do You Favor *Federal* Liability Reform?



Aspects of reform that matter most to respondents are “reform of punitive damages” (46.6%) and “replacement of joint and several liability with proportionate liability” (38.4%).

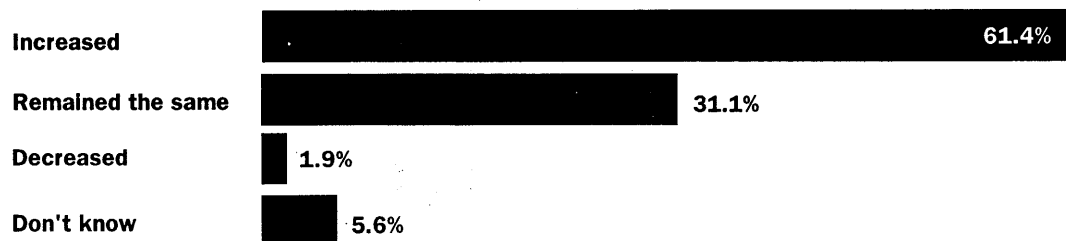
What Aspect of Legal Liability Reform is Most Important to You?



This attitude most likely springs from respondents’ own legal liability concerns. Exposure to legal liability has risen over the past several years, with 61.4% of 1996 respondents saying that their exposure had increased, compared to 55.8% and 57.0% of respondents, respectively, who said it had in 1994 and 1993[†].

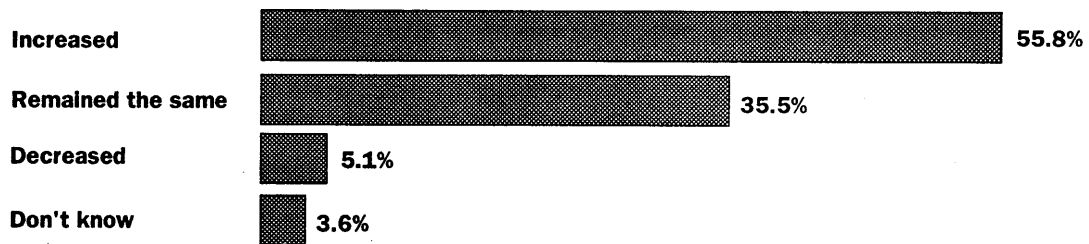
During the Past Five Years, Has Overall Exposure to Legal Liability:

1996 survey

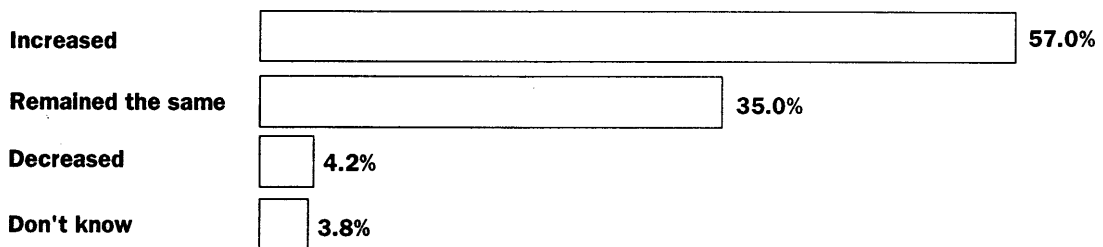


[†]1996 includes survey information gathered from five states where 1993–94 data compares all states.

1994 survey

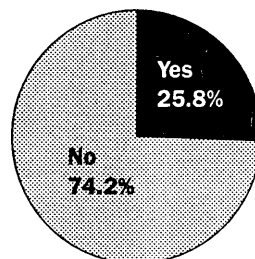


1993 survey

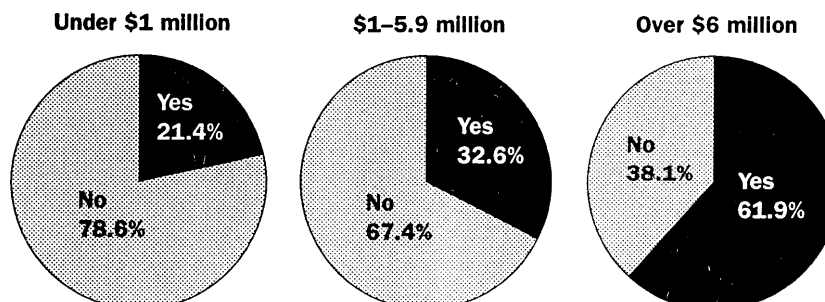


In fact, one in four respondents (25.8%) have been party to a lawsuit in the past five years. Companies with annual revenues in excess of \$6 million have been hardest hit: they were much more likely than smaller companies to be the target of litigation.

Company Been Party to Lawsuit in Past Five Years?

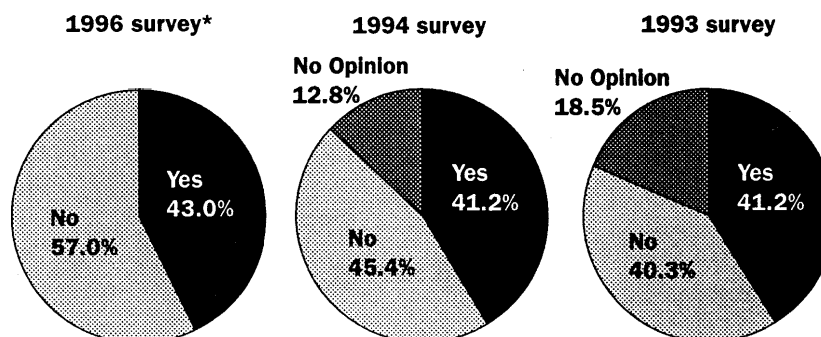


Company Been Party to Lawsuit in Past Five Years: By Company Size



Consistent with prior years[†], more than four out of ten respondents (43.0%) say that the current litigious environment has directly harmed their business:

Current Litigious Environment Hurt Business?



*No opinion not a category in 1996.

Of those respondents who say they have been hurt, many are taking actions that will directly impact the economics of their businesses. Slightly more than half (52.1%) “increased liability insurance,” a new category this year. One-third of this year’s respondents “increased the selling prices of good/services,” compared to slightly over half who said so in 1994 and 1993 .

[†]1996 includes survey information gathered from five states where 1993–94 data compares all states.

Steps Taken in Response to Litigious Environment*

	1996 survey	1994 survey	1993 survey
Increased liability insurance:	52.1%	**	**
Increased selling prices:	31.9	50.7%	50.8%
Terminated employees:	23.9	26.0	19.0
Dropped product/service lines:	20.9	24.7	23.8
Withheld new products:	9.2	19.2	11.1
Closed facilities/offices:	9.2	5.5	4.8
Dropped liability insurance:	5.5	**	**
Other:	7.4	16.4	14.3

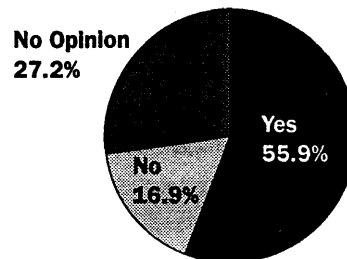
* respondents were asked to select all that apply.

** not a category that year.

The Disclosure Burden

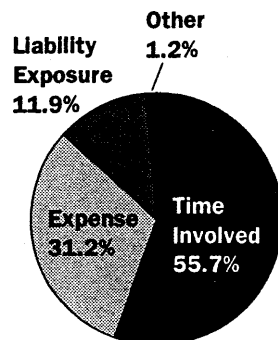
One area of concern to PCPS is whether preparation of financial statements in accordance with GAAP poses a burden to small, non-public companies. More than half (55.9%) of the respondents seem to indicate that financial disclosure is a burden.

Information Required to Disclose on Financial Statements Irrelevant or Too Detailed?



Respondents cite "time involved" (55.7%) as the greatest cost:

What Poses Greatest Burden?

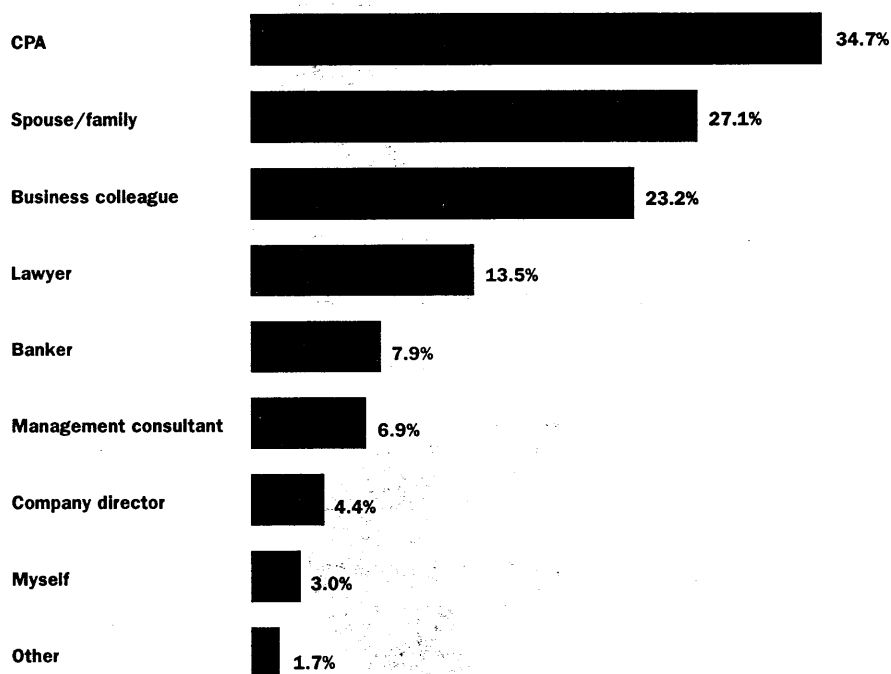


Relationships with CPAs and Lenders

It's important for small business owners to know where to turn for business counsel. In 1994[†], when asked: "Whom do you rely on for business decisions," respondents ranked CPAs just slightly behind "spouse/family." This year, CPAs lead: 34.7% of respondents rely most on their CPA for business advice, followed by "spouse/family" (27.1%).

Outside Your Own Management Team, On Whom Do You Rely Most When Making Significant Business Decisions?

1996 survey



Fortunately, given respondents' reliance on CPAs, a large majority (90.2%) are "very satisfied" or "satisfied" with the services they receive from their financial professional.

[†]1996 includes survey information gathered from five states where 1994 data compares all states.

Overall Satisfaction With The Services of Your CPA Firm

Very satisfied:	51.2%
Satisfied:	39.0
Moderately dissatisfied:	7.5
Very dissatisfied:	2.3

When asked to characterize their banker's ability to support company goals, one in three (33.6%) respondents said "very able," up from 1994:

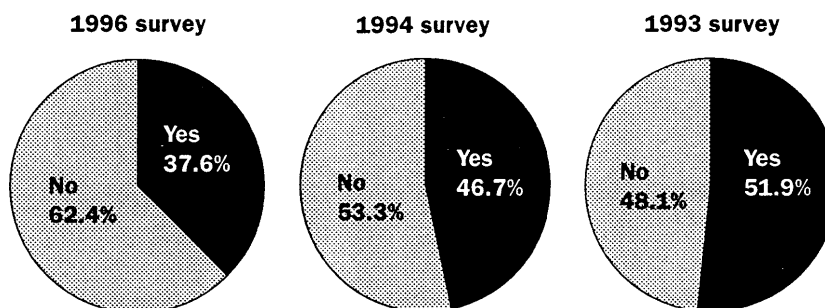
Banker Ability to Support Company Business Goals

	1996	1994	1993	1992
Very able:	33.6%	30.9%	39.5%	40.2%
Moderately able:	34.9	35.1	33.8	34.4
Not particularly able:	24.0	20.7	18.9	16.0
Not at all able:	7.5	13.3	7.9	9.4

Borrowing Trends

Borrowing remains somewhat sluggish among small business owners, with the percentage of total companies saying they had borrowed within the past twelve months dipping to 37.6% as compared to 46.7% and 51.9% in 1994 and 1993 respectively[†].

Has Your Company Borrowed Money in Past 12 Months?



Responses varied by industry group, with highly capital-intensive businesses particularly manufacturing and wholesale/distributing understandably borrowing more frequently than service businesses.

[†]1996 includes survey information gathered from five states where 1995 data compares all states.

Has Your Company Borrowed Money From a Bank in the Past 12 Months: By Industry

	Manufacturing	Construction	Wholesale	Healthcare	Svcs/Consulting
Yes:	46.3%	44.8%	46.7%	32.6%	31.6%
No:	53.7	55.2	53.3	67.4	68.4

Even the largest borrowers appear to be borrowing less than in prior years[†]. In 1994, 81.0% of the companies surveyed with greater than \$6 million in annual revenues said that they had borrowed money in the past year. This year, that percentage fell to 61.9%.

Has Your Company Borrowed Money in Past 12 Months: By Size

	Under \$1 mil.	\$1.0 mil.–\$5.9 mil.	\$6 mil. or more
Yes:	34.1%	44.2%	61.9%
No:	65.9	55.8	38.1

When asked why they hadn't borrowed money, this year's respondents—consistent with previous years—cited “no need for capital” and “have other sources of capital” as the two leading reasons.

Why Didn't You Borrow in the Past 12 Months?*

No need for capital now:	55.7%
Have other sources of capital:	23.0
Do not borrow from banks:	12.6
Bank tightened credit standards:	9.6
Not enough collateral:	7.8
Refused by bank:	7.8
Other:	1.3

* respondents were asked to select all that apply.

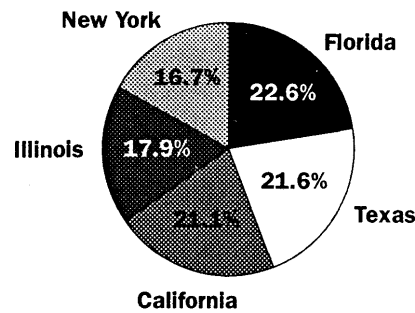
[†]1996 includes survey information gathered from five states where 1994 data compares all states.

RESPONDENT DATA

Geography

Respondents were from five states: California, Florida, Illinois, New York and Texas, distributed as follows:

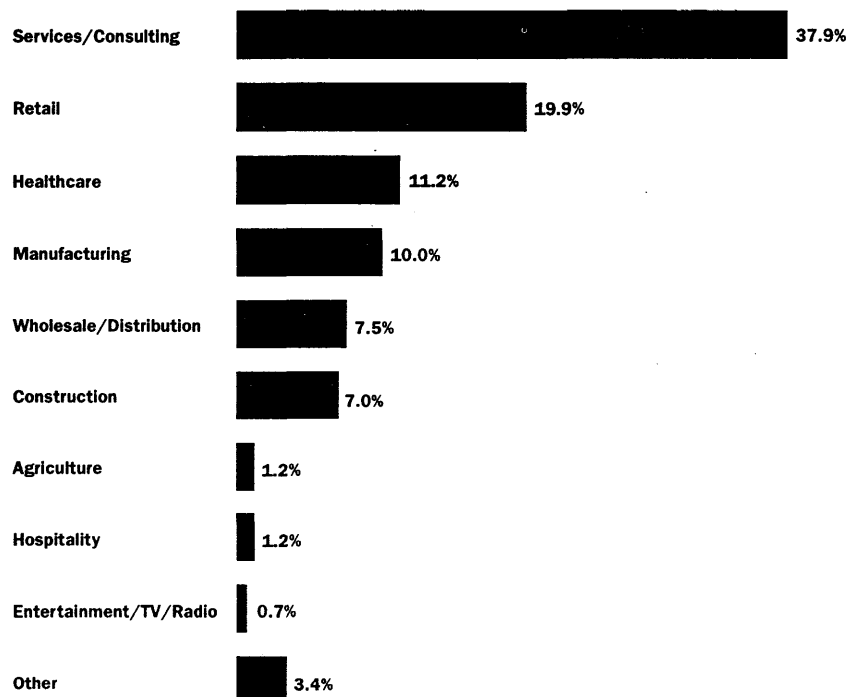
Location of Companies Responding



Industry Group

Respondent companies operate in the following industries:

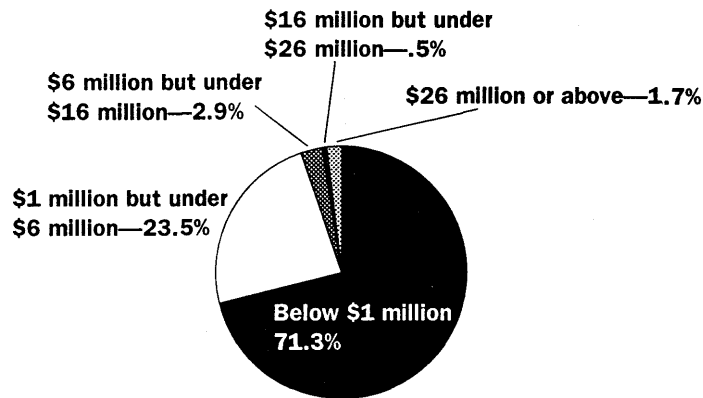
Industry Composition of Companies



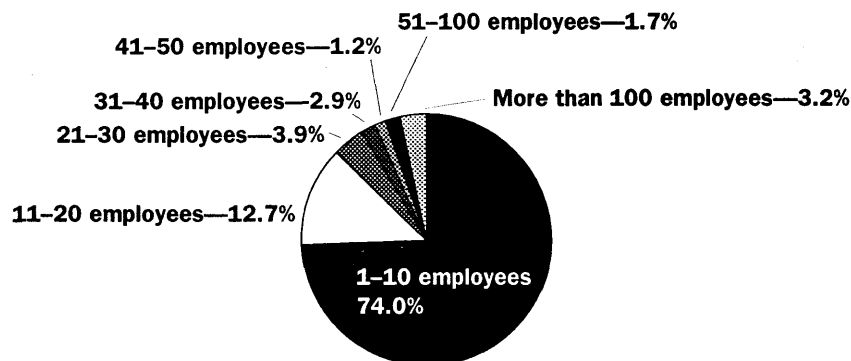
Revenues and Employees

Nearly 95% of the respondents had less than \$6 million in annual revenues during the most recent fiscal year, and almost 90% employ fewer than 20 full-time people:

Annual Revenues of Respondent Companies



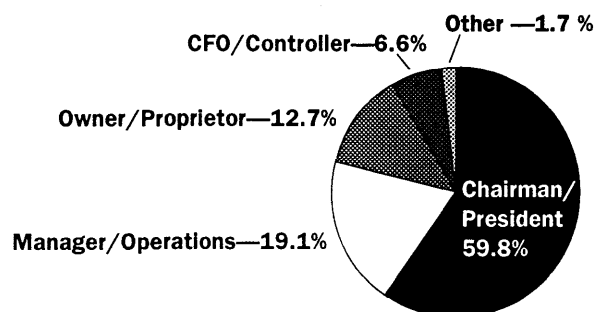
Number of Full-Time Employees



Respondent Title and Company Equity

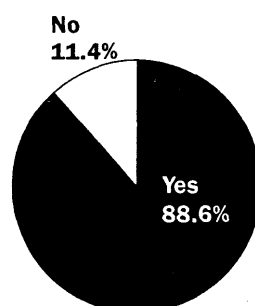
An overwhelming majority of respondents are decision-makers at their companies. Almost three out of four (72.5%) hold the position of Chairman/President or Owner/Proprietor.

Respondent Position

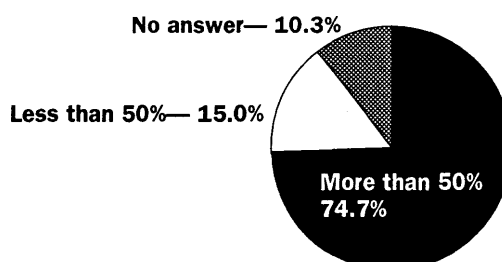


About 90% of the respondents have equity in the respondent company, and of these, nearly three-quarters (74.7%) own controlling interest. These results indicate that respondents are in a position to know what factors affect their company's performance.

Do You Have Equity in the Company?



If Yes, Do You Own More or Less than 50% Equity?



ABOUT THE AICPA PRIVATE COMPANIES PRACTICE SECTION

The Private Companies Practice Section (PCPS) of the American Institute of CPAs is the largest national body of CPA firms that serve private companies. The PCPS comprises nearly 7,700 CPA firms nationwide representing approximately 80,000 CPAs in more than 10,000 offices. The PCPS is part of the American Institute of CPAs, the national professional association of CPAs with more than 328,000 individual members.

This 1996 Small Business Survey is part of a continuing effort by PCPS and its members to monitor key issues affecting privately held companies.

For more information about PCPS, call David Handrich, PCPS Senior Technical Manager, at 201-938-3034. For additional information about this survey, please contact Pat Coate at 212-840-1661.