

The December 2005 CIT Small Business Outlook

Sharing the Pie: Capital and Control



A Study of U.S. Small Businesses

Commissioned by CIT and
conducted by BusinessWeek
Research Services

Sharing the Pie: Capital and Control

Study Background

Introduction

Welcome to the fourth wave of the CIT Small Business Outlook Study, which provides timely insight into American small businesses. The current study focuses on important issues such as:

- Finding capital to start a business
- Raising additional capital
- Preferred sources of capital and advice; and
- Opinions about working with outside investors

In addition, the current wave includes a tracking section that follows up on issues that have been explored in prior waves, such as current and future business conditions, spending and investment intentions, and sales revenue performance and forecasts.

Research Methodology

The CIT Small Business Outlook Study is commissioned by CIT Group Inc., and conducted by BusinessWeek Research Services (a division of the BusinessWeek marketing department). CIT and BusinessWeek Research Services collaborated to design the methodology and questionnaires for each wave of the survey.

Respondents for each survey were obtained from the BusinessWeek Market Advisory Board database, an online panel consisting of over 13,000 BusinessWeek magazine subscribers and online registrants. InsightExpress, an independent third-party research firm located in Stamford, Connecticut, managed the online survey and data collection process. The margin of error for this wave of the study is +/-5 percentage points.

As in prior waves, all respondents are owners, partners, executives, or senior managers at companies that have fewer than 1,000 employees, and gross annual sales of less than \$15 million. All respondents are also key influential 'business decision makers' within their companies or firms.

Interviews for this wave of the study were conducted in October 2005 with 353 respondents. Prior waves were completed in May 2004, September 2004, and May 2005 with about 450 respondents in each wave.

For more information about CIT Group, Inc., please visit www.cit.com.

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Small Business Profile

A Snapshot of Diverse Small Business Leaders

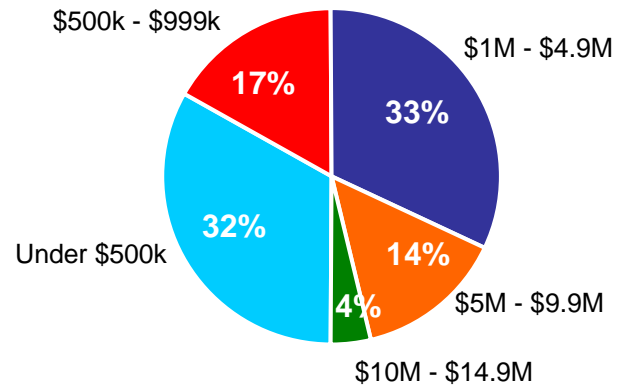
To obtain the most accurate and insightful information about the current state of small business in the United States, the CIT Small Business Outlook survey includes the opinions of only those small business owners, partners, and executives who are responsible for the strategic direction and/or financial stability of their companies.

The characteristics of the respondents in this wave of the study are similar to those in prior waves. Half of respondents (47%) are small business owners or partners. Participating businesses tend to focus more on business-to-business revenue than on consumers. Nearly every participating business (99%) is privately-held. More than one out of ten is in a start-up stage (13%), half are in a growth stage (51%), one-third are in a mature stage (31%), and less than one out of ten is in a consolidation or transitional stage (6%).

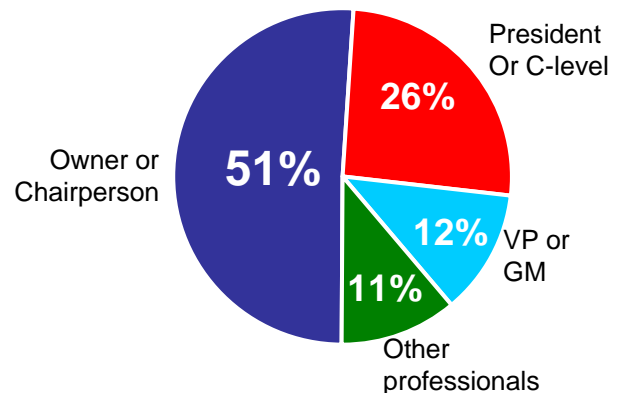
The study participants represent more than 40 different kinds of businesses and industries, with a high concentration in consulting services, information technology, healthcare and pharmaceuticals, publishing, financial services, real estate, manufacturing, and construction.

Wave 4 Small Business Sample (almost identical to prior waves)

2005 gross annual sales revenue



Owners & top management surveyed



Note: percentages in graphs may not add to 100% due to rounding

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Stable Expectations

Maintained Strong Performance and Reservations About the Overall Economy

Small businesses continue to perform well and maintain an optimistic perspective about their own performance. However, small businesses also continue to have mixed opinions about the future of the U.S. economy as a whole.

For example, seven out of ten small businesses (71%) have performed well over the past 12 months (relative to the economy). Most are also optimistic about their future prospects, as more than eight out of ten businesses (83%) expect their 2006 gross annual sales to be higher than their 2005 revenue.

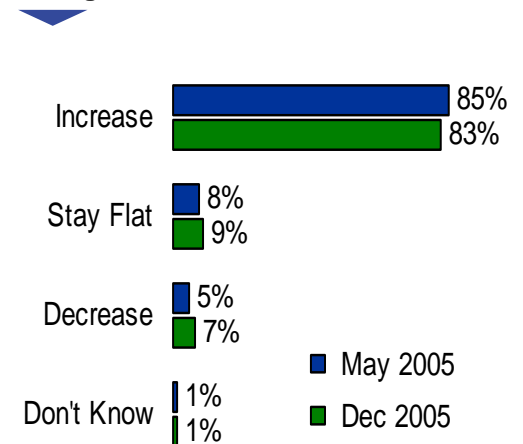
At the same time, small business owners and decision-makers have some reservations about the economy as a whole. Confidence remains at moderate levels regarding the future of the US economy (57%), the spending of US companies in the near future (53%), and the likelihood that unemployment rates will improve (33%). The good news is that, although small business leaders are now less confident about the overall economy than they were a year ago, their level of confidence is now stable as compared to their confidence six months ago. The one exception is expectations for consumer spending: small business leaders are now less likely than they were six months ago to believe that consumer spending will increase in the near future (33% vs. 43%).

Businesses that are most confident about the future of the general economy include those that have revenue of at least \$1 million, and those that expect their revenue to increase in the near future.

Although they maintain a sense of mixed confidence, many small business leaders (74%) still believe that now is a good time for companies to invest in their organizations. As described in the next section, many small businesses expect to increase their spending in various areas.

Maintaining Strong Performance

Compared to 2005, do you expect your 2006 gross sales revenue to.....



Macroeconomic Issues

Percent that agree.....

	May-05	Dec-05
I'm confident about the future of the U.S. economy	57%	57%
Now is good time for companies/firms to invest in their organizations	75%	74%
My company has performed well over the last 12 months relative to the economy	69%	71%
U.S. companies will increase their spending levels over the next 12 months	57%	53%
Consumer spending will increase over the next 12 months	43%	33%
Unemployment rates in the U.S. will fall over the next 12 months	33%	33%

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Raising Capital

Raising and Borrowing Money Remain Common Strategies

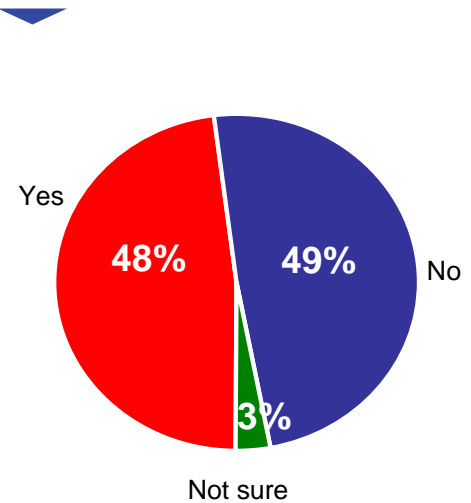
Before they can experience the joy of success, small businesses need to get past the “start-up hurdle.” Small businesses are overwhelmingly built from the ground up (92%), although some businesses are formed through buyouts of other partners (3%), acquisitions of other firms (3%), and franchise purchases (1%).

No matter what phase they are in, one thing is always certain for small businesses: the need for capital. Small businesses are most likely to obtain their initial capital influxes from a single person’s funds (51%), or the funds from two or more partners (38%). Some small businesses also obtain start-up funds from third-party lenders (10%), corporate funds (3%), and venture capitalists (2%).

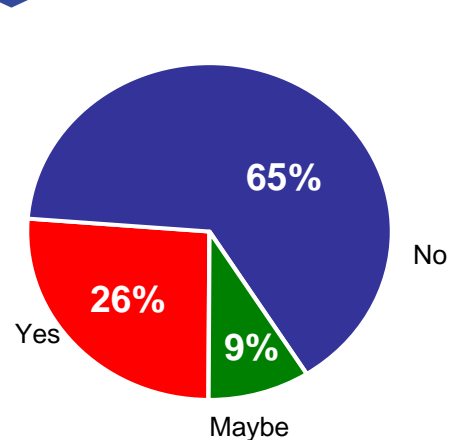
Once they get started, the struggle for capital continues. Firms face many tough challenges, including: growing sales (38%), managing their finances (25%), staying ahead of their competitors (14%), providing customer support (11%), and providing healthcare for employees (6%).

Therefore, just as in prior waves of the study, about half of small businesses (48%) say that they have raised or borrowed money to obtain cash for their operational needs, and one-third (36%) say that they will have a definite (26%) or possible (10%) need to raise or borrow money within the next 12 months. Businesses that have raised capital in the past are more likely to raise capital again than businesses that have never raised capital.

Raised Capital in the Past?



Plan to Raise Capital in Next 12 Months?



Sharing the Pie: Capital and Control Meeting Spending Needs

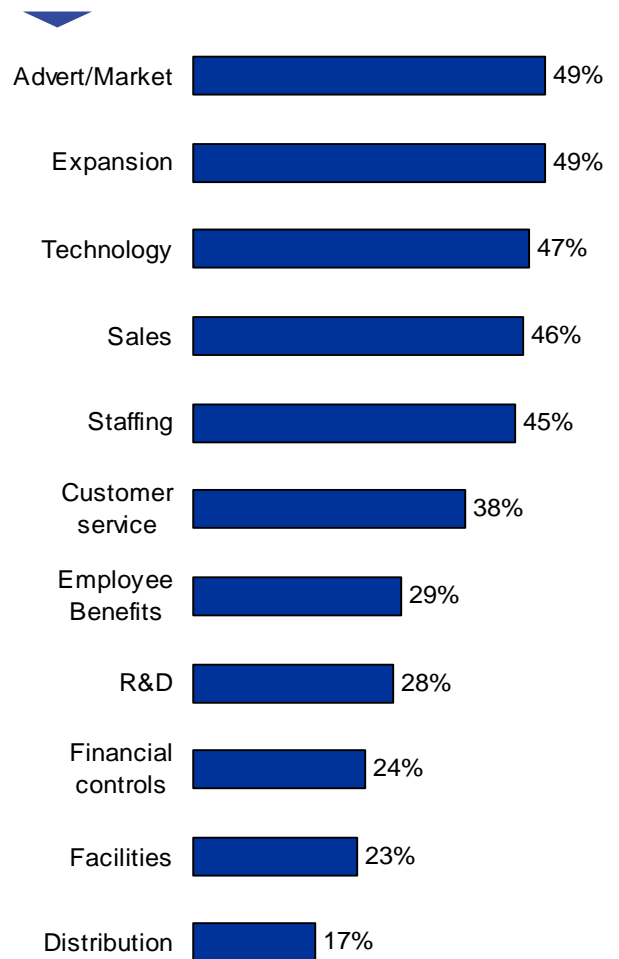
Successful Spending = Successful Business

Companies also need capital to address their spending needs. For example, small businesses plan to raise or borrow money to increase spending for a wide variety of goals, including: product/service expansion (16%), facilities (13%), technology (13%), marketing (13%), staffing (12%), sales support (11%), customer service (9%), research and development (9%), distribution (6%), financial controls (5%), and employee benefits (5%).

Different kinds of businesses have different spending needs. For example, those businesses that expect to borrow or raise money are more likely than other businesses to say that they will increase spending in a variety of areas. In addition, businesses that expect to increase revenue are more likely than others to increase spending for any and all business needs.

Also, businesses with higher and lower revenue have different spending plans. As might be expected, businesses with lower revenue are more likely than other businesses to increase spending on research and development; lower revenue businesses are probably in a start-up mode, so new development is essential for them. On the other hand, businesses with higher revenue are more likely than other businesses to increase spending in areas that are associated with growth maintenance, such as staffing, customer service, sales support, and product/service expansion.

Small businesses expect to increase spending for:



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Sources of Capital

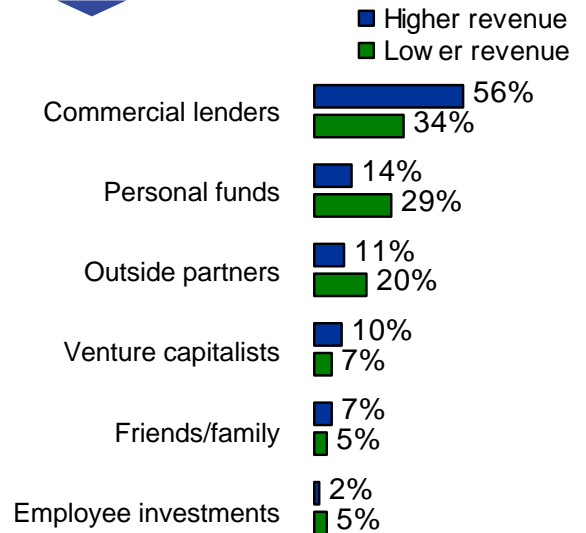
Outside Investors Used by Some, But Avoided by Many

It is clear that small businesses need capital, but what sources of capital are available to them? Small businesses most prefer to obtain money from: commercial banks, lenders and finance companies (45%); their own personal funds (22%); outside partners (15%); venture capitalists (8%); friends or family (6%); or their own employees (4%). Businesses that have raised capital in the past are more likely than other businesses to consider commercial lenders, while businesses that have not raised capital are more likely than other businesses to prefer tapping into their own personal funds. In addition, higher revenue businesses are more likely than other businesses to prefer using commercial lenders, while lower revenue businesses are more likely than other businesses to consider using friends and family, personal funds, and outside investors.

One source that small businesses prefer to *avoid* is “outside investors.” Although four in ten businesses (37%) would consider using outside partners, six out of ten small businesses (63%) would not consider tapping into outside partners. Types of businesses that are least likely to consider using outside partners include those that: have many employees, have high revenue, use sole proprietorship ownership, have not needed additional funds in the past, have no expectation to raise capital in the next 12 months, and have not used outside investors in the past.

Although they need capital, small business owners prefer to hold onto their control of their businesses. Owners and decision-makers say that the following factors weigh heavy on their minds when they think about using outside investors: impact on managerial control (52%); impact on strategic decision-making (51%); expertise of outside partners (48%); commitment of outside partners (47%); outside partners’ understanding of their business (45%); partners’ impact on bureaucracy (32%); and impact on profit sharing (29%). The good news is that small businesses do not need to use outside investors to raise capital; as described above, there are many other sources of capital available to them. However, businesses that have used outside investors in the past are more likely than others to prefer using outside investors in the future.

Preferred Funding Sources, By Revenue Level



Why would your company prefer to use commercial lenders to raise additional funds?

“Banks...do not get involved in daily operations and strategies of a small business.”

“These lenders often do not encroach on management decisions.”

“With family, they want to know how you invest their money and sometimes you cannot even tell them to mind their own business.”

“Banks are neutral.”

“Keep it business-only, not personal.”

“Professionalism without cannibalism”

“Can retain ownership and control of our company.”

“They bring experience.”

“Less problems.”

“Privacy.”

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Trusted Advisors

Small Businesses Trust Many Formal and Informal Advisors

Raising capital involves some difficult decisions, so it is important for small businesses to have helpful and valued advisors. Businesses say that they are most likely to tap into the following confidants when making financial decisions: CPAs/Accountants (74%); lawyers (46%); colleagues (41%); commercial lenders (31%); business associations (28%); family and friends (25%); consultants (20%); and investment bankers (8%).

Sources of advice vary by revenue level. For example, lower revenue businesses are more likely than others to tap into informal advisors, such as family, friends, and colleagues. On the other hand, higher revenue businesses are more likely than others to tap into professional advisors, including CPA's/accountants, lawyers, commercial lenders, professional consultants, and investment bankers.

Finally, since commercial lenders are small businesses' most preferred source of capital, what do small businesses look for in a lender? Small business leaders are demanding and place importance on a wide variety of lender characteristics, including: competitive interest rates (96%); flexible financing terms (92%); customer service (87%); lender's reputation (82%); specialization in small business financing (78%); an understanding of their business (78%); a low amount of bureaucracy (76%); and offering of specialized loan programs for their industry (56%).

Sources of Advice, By Revenue Level

