

EXECUTIVE SUMMARY

*Small-business owners respond to cost increases with a variety of specific actions. The most frequently taken actions include absorbing the increased cost in the form of lower earnings or profits, higher selling prices, and reductions in the use of the good/service whose cost rose, e.g., energy conservation when energy costs rise. Employee-related measures, e.g., layoffs, or altered investment patterns are not taken often unless they are the good/service whose cost increases.

*Small-business owners are likely to take more than one specific action to adjust for cost increases. Sixty-four (64) percent of small-business owners adjusted to energy cost increases earlier in the year with multiple actions. Thirty-one (31) responded with a single action.

*Specific actions taken to adjust for cost increases are strongly influenced by the size of the price increase, the amount of time the increase is known prior to its implementation, i.e., advance notice or knowledge, and the good/service whose cost increases.

*Small price increases are more likely to be absorbed than larger ones. For example, almost 60 percent say that the first step they would take to offset a five percent cost increase in physical facilities costs (if they know of it only a week ahead of time) is to absorb it. Half that number would do so if the increase was 15 percent. Large price increases are more likely to be met initially with steps focused on reducing payroll costs or business investment.

*The more advance notice or knowledge of a cost increase, the more likely a small-business owner will be able to pass on cost increases in the form of higher selling prices. For example, 38 percent facing a five percent payroll cost increase with six months advance notice say that they will first raise selling prices in response. That percentage is halved with one week notice.

*Between one in four and one in five small-business owners report that it is “highly likely” or “likely” that cost increases with no notice will force them to borrow or draw down on a line of credit to ease adjustment to a new cost structure.

*Payroll, physical facilities (plant), and energy cost increases are examined in this report. Small-business owner reaction to cost increases varied little by the good/service, e.g., payroll, whose cost increased. When the cost of a good/service rose, steps were often taken to reduce its consumption. However, only a portion of the increase was offset by reduction in the use of the good/service whose cost was raised.

*Seventy-six (76) percent of small employers report that their total energy costs had risen since the beginning of the year. Those experiencing increases adjusted to them with lower earnings or profits (75 percent), reducing energy consumption, i.e., conservation (57 percent), raising selling prices (29 percent), cutting, eliminating or delaying business investment (27 percent), laying off employees or not filling existing vacancies (13 percent), and freezing or cutting employee wages and benefits (13 percent).

ADJUSTING TO COST INCREASES

Cost control is one of the most formidable management problems small-business owners encounter. A primary reason for its difficulty is that no matter how skilled or well-trained the small-business manager, cost increases are inevitable. Even when inflation rates are negligible, the cost of some goods and services rise (and some fall) reflecting a market economy's constant reshuffling of relative value. Moreover, cost increases can be forced on owners, such as an uninsured loss or a government mandate to incur costs the business otherwise would not. When these new costs appear, small-business managers have several options available to adjust for them. For example, they might raise their own selling prices to recover the additional costs incurred. Or, they might cut business investment or delay it until other arrangements can be made. They might choose an alternative (and cheaper) supplier. Or, they might simply elect not to purchase a product or service at the new, higher price and substitute something else. They might also lower their earnings or profits. But each choice has consequences, most of them undesirable. Raising prices may chase away some customers; laying off people or not filling existing vacancies may result in poorer quality of service; cutting investment may mean falling behind the competition in productive efficiency. Small-business owners and managers, therefore, must carefully consider their options when adjusting for cost increases. This edition of the *National Small Business Poll* focuses on the actions small-business owners take to adjust for cost increases and how those adjustments vary under differing conditions.

Comparing Reaction to Cost Increases

Small-business owners reacted to three different types of cost increases -- payroll, physical facilities (plant) and energy -- in the survey on which this report is based. Payroll and physical facilities cost increases used four hypothetical cost scenarios each. The first scenario involved a five percent payroll/physical facilities cost increase (small increase) and the small employer knew that it was coming six months in advance (advance notice). The second scenario involved a larger cost increase, in this case 15 percent (large increase). The small employer also knew of this cost increase six months ahead of time (advance notice). The third scenario again involved a five percent rise (small increase), though this time the increase would occur the following week (no notice). Finally, small-business owner respondents were told that they could expect their payroll/physical facilities costs to rise 15 percent (large increase) next week (no notice). After being presented each of these four potential situations, they were asked, "What is the most likely step that you would take to pay for this cost increase?" In other words, how would small-business owners handle payroll/physical facility cost increases of different sizes and with different degrees of notice? A subsequent series of questions was posed about the competitive environment in which the firm operates. They addressed such issues as current comparative price levels, the degree of competition, and the percentage of total costs payroll/physical facilities represented.

The energy inquiry differed somewhat because it was based on actual experience. The question was how "did," not how "would," small-business owners offset energy cost increases. There was effectively only one "scenario" and it was the actual situation. The energy inquiry also asked about the use of multiple actions to adjust to price increases where the prior two solicited information only about the single "most likely." However, small-business owners also identified the single "most important" action. They were asked further about expected energy cost increases for the remainder of the year and how they plan to compensate for them.

Payroll Cost Increases

The most frequent step small-business owners would take in case of a small payroll increase with advanced notice is to raise selling prices. Thirty-eight (38) percent indicate that higher prices is the first

action that they would take under the circumstances (Q#1). The second most frequent step they would take is to absorb the increase with lower earnings or profits. Twenty-three (23) percent believe that they would absorb the five percent payroll increase even if they knew about it six months in advance. Another nine percent volunteer that they would do nothing which appears effectively to be another way of saying that they would absorb the increase. If this interpretation is correct, 32 percent would pay for the increase with lower earnings. Eleven (11) percent say that they would lay off employees or not fill existing vacancies. Another seven percent would freeze or lower employee wages or benefits meaning that 16 percent would force employees to pay the cost in less or lower paid (relatively) employment. That means the cost of the payroll increase, or even a large portion of it, would not necessarily be passed back to employees as economists widely believe, at least not within the near-term. Finally, seven percent would also defer, reduce or eliminate business investment to offset the increase. Thus, under the most benign payroll scenario, i.e., small increase/advance notice, adjustments would be broadly spread among the options available.

The second scenario increases the size of the payroll increase to 15 percent, again with six months advance notice. The most frequent step to pay for this cost increase would also be selling price hikes. Virtually the same number as with the five percent increase, 37 percent, say that they would raise prices (Q#2). However, the proportion willing to absorb the increased cost with lower profits or earnings and the proportion intending to pass the cost back to employees switch positions. The 15 percent payroll cost increase finds 19 percent laying off people or not filling existing vacancies and another nine percent lowering relative pay or benefits. Thus, 29 percent would pass the cost increase through to employees, the “beneficiaries” of the payroll cost increase. That is almost twice the proportion as in the five percent payroll increase response. Eleven (11) percent say that they would absorb it and another six percent would do nothing. That effectively means half as many would be willing to accept lower earnings as a first step under this relatively large increase/advance notice scenario than in the relatively small increase/advance notice scenario

Scenario three changes back to a five percent payroll cost increase, but the small employer only recognizes the cost increase the week before it will occur. With less time to make adjustments, almost half (49 percent) of survey respondents forecast that they would absorb the increase with lower earnings or profits as their first step (Q#3). Another seven percent feel that they would do nothing for a total of 56 percent anticipating lower earnings. The action identified with second greatest frequency is raising prices (18 percent). Just seven percent indicate that they will lay off people or not fill vacancies and another six percent will reduce relative wages and/or benefits. Thus, the primary difference in small employer responses to a relatively small payroll cost increase with no notice compared to advance notice is that the owner instead of the customer(s) is most likely to bear the brunt of the cost increase, at least initially. While over the longer term the small-business owner will likely need to spread the higher cost across a range of options, possibly including lower earnings, shorter term adjustment is another issue.

The final scenario involves a large payroll increase with no notice. Small employers approach the problem by sharing the burden with their employees to a far greater extent than with the smaller increase. Nineteen (19) percent say that they would lay off employees or not fill existing vacancies and another nine percent would reduce relative compensation (Q#5). In other words, about 28 percent would impact employees rather than the 13 percent in the five percent payroll increase/no notice scenario. About the same proportion would reduce earnings as a first step (27 percent) in addition to those volunteering that they would do nothing (4 percent). The reduce earnings group is down to 31 percent from the 56 percent (combined lower earnings and doing nothing) in the five percent payroll increase/no notice scenario. Nineteen (19) percent also indicate that they would raise prices. Nine percent report that they would cut, eliminate or delay business investment. Four percent, and an alarming 10 percent in the 20 or above firm size category, volunteer that no adjustment could be made with such a large increase and such short notice. They say that they would either be forced out of business or forced to sell.

A comparison of small-business owner adjustments between small and large payroll increases and between payroll increases with advance notice and no notice leads to two general observations: first, small-business owners appear more inclined to absorb small increases in the form of lower earnings or

profits than they are large ones. About twice the percentage say they will first adopt the reduced earning option when the increase is small compared to when it is large. The opposite occurs with employee-related cost reductions. Larger increases result in small employers taking employee-related actions almost twice as often as with smaller increases. Second, the most notable difference between no notice and advance notice appears to be the perceived capacity to raise prices. When small-business owners know of cost increases six months in advance, over one-third elect to raise selling prices as their first choice to offset cost increases. Without notice that percentage is more than halved with either the large or the small increase.

a. Factors Influencing the Choice of Adjustment Steps

Several environmental factors likely will influence a small employer's choice of steps used to adjust to payroll cost increases. The factors can be identified generally, but each should affect a firm differently and thereby influence the owner's choices differently. While the number of possible factors is large, the survey identified four important ones for further inquiry:

1. payroll as a proportion of total expenses,
2. current ease/difficulty attracting and maintaining qualified employees,
3. current selling prices compared to competitors, and
4. competition in the firm's primary market

When payroll costs are a small part of total business costs, a five or 15 percent payroll increase represents a comparatively small expansion in the firm's cost structure. The adjustment required is, therefore, relatively modest. The opposite is true if payroll constitutes a large share of total business costs. A five or 15 percent payroll increase under those circumstances could be substantial and require a major adjustment. Hence, payroll as a percentage of total business costs should influence a small employer's choice of adjustment actions, and it appears to do so. When payroll as a percentage of total business costs is cross-tabulated by the four payroll scenarios (Q#1, Q#2, Q#3, and Q#5), the larger payroll as a percentage of costs is, the less likely small-business owners will choose to absorb cost increase with lower earnings. For example, in the small increase/advance notice scenario, those with payroll costs of <10% of total costs would absorb those costs as a first step 46 percent of the time; the 10% - <20% group, 39 percent of the time, the 20% - <30% group, 35 percent; the 30% - <40% group, 30 percent; and, the 40% - <50%, 15 percent. Only the 50%+ group interrupts the pattern with its 25 percent. The exception was the small increase/no notice scenario. A majority absorbed increased costs as a first step in the scenario and payroll as percent of total business costs appeared to make no difference. Still, these data on balance nicely fit the idea that smaller increases are far more likely to be absorbed and larger ones spread among a variety of options.

Another influencing factor is likely to be the difficulty attracting and keeping qualified employees. If labor markets are tight and qualified employees difficult to locate, employers should be less inclined to take employee-related measures to adjust to cost increases, and vice versa. However, the difficulty of attracting and keeping qualified employees (Q#8) does not appear to be associated with the propensity to take employee-related measures. Those who find employees more difficult to attract and keep seem no more inclined to take such steps other than employee-related than those who find it easy. One explanation may be that small-business owners are reluctant to exercise employee-related options, even when payroll is the subject of the cost increase. Only when matters grow serious, such as in the large increase/no notice scenario are these actions used frequently. Another may be the relationship (or lack of one) the owner establishes with his employees. Those who have experienced little employee turnover may come to regard employee-related measures as unacceptable responses. A third could be that owners with low turnover simply don't know the current labor market very well.

A firm's selling prices compared to its primary competitors is another factor likely to influence a small-business owner's choice of actions when adjusting for payroll cost increases. If a firm undersells

the competition, there may be some margin for selling price increases. If the competition undersells a firm, the selling price option may be limited. However, the data offer no support for this idea. The explanation for the lack of support may be that most small-business owners feel their selling prices are currently about the same as their primary competitors' (Q#16). This perception alone may serve to constrain the possibility of passing cost increases through to the customer. Further, the small-business owner's decision is complicated by the knowledge (or lack thereof) that competitors face (or do not face) similar cost increases.

The competitiveness of a particular market (Q#17) may also influence a small employer's choices of adjusting to payroll cost increases. A less competitive market seemingly would give a small employer more latitude in the decisions made. More latitude, other factors equal, would make it less likely that owners would choose to lower earnings and possibly to take employee-related measures. The most likely option would, therefore, appear to be raising prices. However, none of the expected associations occur. In fact, the relationship that does occur is counter-intuitive. In scenario three, i.e., small increase/no notice, those who claim to be in the least competitive markets are most likely to absorb the increase in payroll costs with lower earnings or profits. It is possible that less competition equates to higher earnings and those owners are best equipped to absorb immediate cost increases and pass them on later.

b. Borrowing to Ease the Adjustment

Sudden price increases can cause cash flow problems for a small business, particularly if the owner cannot immediately find a place to slash expenses or easily raise prices. One way to get "over the hump" until other arrangements can be made is short-term borrowing. Five percent of those facing a five percent payroll increase next week (scenario three) report that it is "highly likely" that they would borrow or draw down on an existing line of credit to ease the adjustment (Q#4); another 18 percent say that borrowing is "likely." About half of small-business owners encountering a small, but abrupt increase in payroll costs, would not borrow to assist adjustment to a higher cost structure.

If the size of an abrupt payroll increase is larger, more small employers logically should be inclined to borrow. But that does not appear to be true. The size of the payroll increase, at least within the parameters posed here, appears of little consequence. Just six percent believe borrowing "highly likely" when facing an abrupt 15 percent payroll cost increase (scenario four) and another 17 percent term it "likely" (Q#6). These figures are similar to the proportion borrowing for a five percent increase. A possible explanation for the unexpected outcome is that larger increases force more dramatic action, e.g., lay-offs. After the more dramatic actions are taken, the amount left to finance may be no larger than when increases are small. It should be noted that when small business owners must borrow in this situation, they incur yet another cost increase that must be incorporated into the adjustment process.

Rising Physical Facilities Costs

Physical facilities constitute a second type of significant costs common to small employers (in addition to payroll costs). These costs involve the firm's physical location(s) and include such items as rent and/or a mortgage, maintenance and utilities. Small-business owners in the survey were presented scenarios for cost increases identical to the payroll cost increase scenarios discussed above, except physical facilities was substituted for payroll.

A relatively small increase in physical facilities costs known well ahead of time engenders a similar response to those presented the same scenario for payroll costs. Thirty-seven (37) percent say they would raise prices as a first step to adjust to the higher costs (Q#9), virtually the same as the 38 percent forecasting payroll cost adjustments under similar conditions (Q#1). Absorbing the increase through lower earnings or profits is cited with second greatest frequency just as with the group assessing payroll. At 34 percent, the proportion saying that they would absorb physical facilities costs is roughly ten percentage points higher than for the payroll group. However, another four percent would do nothing compared to nine percent of those reacting to payroll increases. Cutting, eliminating, or postponing

investment (7 percent), laying off employees or not filling existing vacancies (7 percent), and reducing relative wages and benefits (5 percent) cluster far behind as the next most frequent choices for adjusting to physical facilities cost hikes. But, at this point the similarity in reactions of the physical and payroll facilities groups diverge. Those facing increases in physical facilities are less likely to make the adjustment through employee-related responses (12 percent) than those facing increases in payroll (17 percent), a disparity that holds for three of the four scenarios.

As the cost increase rises to 15 percent, the proportion willing to “eat” the new expense as a first step in the adjustment falls by two-thirds (Q#10). This decline is offset by marginal increases in virtually every other option presented for consideration and some that were not. The largest increase (10 percentage points to 17 percent) comes from those intending lay offs or not filling currently open positions. But even the volunteered response of “changing locations” drew five percent, up from the negligible response of the prior scenario. Twenty (20) percent select employee-related steps when confronted with a 15 percent physical facilities increase and advance notice while 28 percent select them facing a similar payroll cost rise (Q#10).

Response to scenario three, i.e., a relatively small cost increase and no notice, shows that a majority (54 percent) would absorb the new costs through lower earnings or profits and another small number (5 percent) would do nothing (Q#11). The second most frequently cited first step is raising selling prices, but only 16 percent select that option. Such response is virtually identical to that reported for scenario three by the payroll increase group (Q#3). Even the employee-related measures are roughly similar, though the payroll group remains more likely to choose them.

A relatively large physical facilities cost increase with practically no notice splinters the consensus existing when adjusting for a small increase without notice. Twenty-seven (27) percent claim that they would absorb the new costs in the large increase/no notice scenario (Q#13); 22 percent say that they would raise prices; 14 percent indicate that they would lay off people or not fill existing vacancies; 13 percent feel that they would change investment plans. Seventeen (17) percent would make an employee-related adjustment compared to 28 percent who face payroll cost increases under the same circumstances.

Comparing small increase/large increase and advance notice/no notice for a physical facilities cost increase yields similar results to those produced for the payroll cost increases. Small-business owners are much more likely to absorb small increases in the form of lower earnings or profits than they are large ones. Over twice the percentage say that they would reduce earning first when the increase is small than when it is large. Small-business owners are also about twice as likely to raise their selling prices when there is advanced notice contrasted to when there is none. The third comparison to note is between the groups responding to physical facilities and payroll cost increases. The sole difference between the two is that the payroll group generally selects employee-related measures about 50 percent more often than the physical facilities group. On the other hand, the physical facilities group is somewhat more likely to select cutting, eliminating or delaying business investment than the payroll group. The latter option is as close to reducing consumption of the good/service rising in price as can be selected with the options available.

a. Factors Influencing the Choice of Adjustment Steps

The same basic factors that were identified and examined as potentially influencing small employer choices in adjusting for payroll cost increases can be assessed for physical facilities costs. However, due to the reasonably long period it takes to make changes in space, e.g., multi-year leases, the tightness of the commercial real estate market was not examined. The three factors remaining were:

1. physical facilities as a proportion of total business expenses,
2. current selling prices compared to competitors, and
3. competition in the firm’s primary market

Differing from all data presented to this point, physical facilities as a percentage of total business

costs did not seem related to the likelihood that a cost increase would be absorbed by the owner. Those with larger proportions, implying total costs of a percentage increase are higher absolutely, did not seem any more or less likely to choose this option. It is not obvious why this particular cost should be treated differently than others, but it appears to happen.

Relative selling prices do seem to influence the election to raise prices in the physical facilities scenarios. That is different from the payroll cost scenarios where no difference appeared. Dividing owners into groups that have about the same or higher selling prices than their primary competitor and that have lower selling prices than their primary competitor, the ones currently with lower prices are more likely to raise them. For example, those currently underselling the market choose to raise prices 45 percent of the time in the first scenario; those currently competitive choose to do so 34 percent of the time. The exception is scenario four where there is no difference and no obvious reason for it.

Finally, the perceived competitiveness of the market in which the firm operates does not seem associated with any step taken to offset physical facilities cost increases. The same was true in the payroll cost increase scenarios.

b. Borrowing to Ease the Adjustment

Small employers facing little/no notice cost increases for physical facilities are also unlikely to borrow or draw down on a line of credit to ease the adjustment. Five percent say that they are “highly likely” to use credit when confronted with a five percent increase (Q#12), about the same number (7 percent) that would be “highly likely” to borrow if the cost increase were 15 percent (Q#14). In addition, 15 percent in both scenarios were “likely” to borrow under the specified conditions. These responses are strikingly similar to those engendered by no advance notice for an increase in the cost of payroll (Q#4 and Q#6). The specific subject of the cost increase appears not to influence the proportion intending to borrow.

Rising Energy Costs

The first half of the year saw significant changes in the cost of energy. Gasoline prices reached more than \$2.00 a gallon in parts of the country. California experienced electricity shortages and was forced to hike rates substantially both to pay for electricity purchases from out-of-state and to reduce its consumption. Natural gas prices rose to unusual heights, particularly during the winter months. Energy, therefore, provides a real cost increase on which small employers could report the actions actually taken to adjust for cost increases.

Small-business owners report that energy cost increases were not as pervasive or steep in the first half of the year as many think. Over three-quarters experienced total energy cost increases (Q#18). (The proper term is unit energy costs. Simplicity dictated the less precise total energy costs.) However, just half believe that energy costs rose more than costs in general. Twenty-six (26) percent report “significantly” higher costs. Still, 22 percent say that since the beginning of the year their total energy costs have risen little or not at all. Moreover, while 39 percent indicate that energy costs have impacted their businesses more than other important areas of business operation, 19 percent list employee health insurance as a cost increase with a greater impact, 16 percent cite the cost of goods, supplies and materials; 13 percent note employee wages and salaries; and, eight percent mention physical facilities (Q#24). The result is that energy cost increases were important to small business in the first half of 2001, but they were not the only important cost increase in the present low-inflation environment. The remainder of this discussion includes only the 76 percent who experienced energy cost increases.

Primary concern focuses on three types of energy – gasoline, electricity and natural gas. More identify cost increases for gasoline as impacting their businesses (33 percent) than any other energy form (Q#19). If the eight percent who note diesel are added, 41 percent indicate that they were most impacted by forms of energy largely used to power vehicles. Electricity was second. Thirty-one (31) cite it as the energy whose price increases caused greatest impact. Concern over the price of gasoline was spread across the country. However, the impact of electricity cost increases focused on the west coast with the

central region also notably affected. Small-business owners in the mid-west disproportionately name natural gas, the third most frequently cited form of energy (22 percent). Fuel oil is mentioned much less frequently (3 percent) and coal (0 percent) never.

The single most important step taken to offset these energy costs increases was reduced earnings. Thirty-eight (38) percent claim that lower earnings was the most important way they compensated for their energy cost increases (Q#21). Conservation actions were taken with next greatest frequency (34 percent). The third most often most important step was raising prices (15 percent), followed by altered investment patterns (4 percent), reduced employment (3 percent), and relatively lower wages and benefits (2 percent).

a. Multiple Steps in Adjusting to Cost Increases

It is possible, if not likely, that when small employers receive a cost increase they take more than one step to offset it. The payroll and physical facilities cases reviewed earlier only obtained the first (and presumably the most important) step. However, those experiencing energy cost increases were asked about each of several possible actions and most indicated that they used more than one. The most frequent step taken to address energy cost increases was absorbing them through lower earnings or profits. Seventy-five (75) percent report use of this action (Q#19C). The second most frequently taken step was reducing the total volume of energy used through conservation measures (57 percent)(Q#19F). Energy conservation is the equivalent of cutting employees or employee compensation in the payroll cost increase scenarios since they both reduce use of the input whose cost is rising. Reducing space or maintenance are the equivalents in the physical facilities case though neither was presented directly due to the difficulty of reducing or changing space (and its cost) in the reasonably short-term.

Far fewer report other actions to offset energy costs increases. Twenty-nine (29) percent say that they raised prices (Q#19A) and 27 percent say that they cut, eliminated or delayed business investment (Q#19E). The slowing economy may have pushed several owners toward the latter choice. The same may be true of employees when 13 percent of small employers chose to reduce employment or not fill existing vacancies (Q#19B) and 13 percent elected to cut relative wages and/or benefits (Q#19D).

Sixty-four (64) percent report that they took more than one action to adjust to energy price increases; 31 percent took only one action; and, five percent took none of the actions listed (not shown). Seventeen (17) percent say that they absorbed the costs entirely with lower earnings while 11 percent say that they were able to do so exclusively through energy conservation measures. Virtually no other single action was used exclusively.

The first or most important steps taken (Q#21) reflect the frequency of actions taken (Q#20). In other words, absorbing the energy cost increase was far and away the most frequent single most important step taken and it was also the step cited most frequently as having been taken. Energy conservation occupied the same relative position in each question and so on. These data support the assumption made throughout this report that the frequency of most important citations is distributed similarly to their frequency of use. That means that even when small-business owners' elect to take more than one action on a payroll or physical facilities cost increase, the distribution of the frequency of their actions likely reflects the distribution of their first choices.

If one considers reduced employment or wages as a conservation measure to counteract a payroll cost increase, the similarity between responses to hypothetical payroll cost increases and actual energy cost increases is intriguing. This is particularly true for the large increase/no notice payroll scenario which is the scenario that appears closest to what actually happened to energy costs earlier in the year. Twenty-seven (27) percent in the payroll scenario say that they would absorb the costs and another four percent say that they would do nothing, meaning about 31 percent would select lower earnings as their first option (Q#5); 34 percent say that they actually reduced earnings as their most important step adjusting to energy cost increases (Q#21). Twenty-eight (28) percent in the payroll scenario indicate that they would reduce consumption of the item whose price was rising, i.e., employees; 37 percent say that they reduced consumption of that item, i.e., energy, in the energy example. Nineteen (19) percent would

raise prices in the former and 16 percent did in the latter. Nine percent would cut investment in the former and five percent did in the latter. The similarity of actions on different types of cost increase in a hypothetical and actual situation strongly suggests that there is a pattern of reaction common to the small-business owner population regardless of the type of cost increase incurred.

b. Expected Energy Cost Increases

By early summer, a majority of small-business owners felt that the worst of the energy cost increases was over. Just 11 percent expect energy costs to rise “significantly” throughout the remainder of the year (Q#22). Sixty-four (64) percent believe that they will rise no faster than costs in general.

Anticipating that energy cost increases will continue throughout the year means that small employers effectively have advance notice that these increases are coming. The most frequent intended response, therefore, is to raise selling prices (30 percent)(Q#23). The second most frequent response is to conserve energy (24 percent) and the third to absorb cost increases with lower earnings (18 percent). Almost 10 percent plan to compensate with business investment cuts and another seven percent expect employee-related expenditure reductions. This distribution of actions resembles a combination of the large and small increase/advance notice payroll scenarios.

c. Factors Influencing the Choice of Adjustment Steps

Relative selling prices, competitiveness of the market, and size of cost increases were compared to the adjustment choices made by small-business owners for energy cost increases. However, the results did not provide strong associations

There is minimal evidence to show that the lower relative selling prices initially, the more likely the owner will elect to raise prices in response to energy cost increases. Those underselling the market were three percentage points more likely to raise selling prices in response to real energy cost increases than were those competitively priced or somewhat above the market. However, it is possible, differing from the hypothetical cases, that energy price increases took some firms from a position of underselling the market to one of price competitiveness. That change would not be reflected in these data. If it did occur, the data may understate the difference in the two. Meanwhile, the gap between the groups with different relative selling prices was seven percentage points when the topic changed to future energy prices increases.

Small-business owners selling at competitive or above market prices would appear to have a particular incentive to conserve energy that those underselling the market would not. The data support that idea. Twenty-five (25) percent of small employers underselling their market selected energy conservation earlier in the year compared to 33 percent of those at market prices or higher. The former group anticipates responding to future energy costs with conservation first in 13 percent of the cases compared to 26 percent for the latter.

The perceived competitiveness of the market has no relationship to any action taken to adjust for energy cost increases. This result is the same as the one encountered in the payroll and physical facilities examples.

The size of the actual energy increase is associated with the most important action taken in response, but not in the way expected. Of those who report energy cost increased “significantly” or “a lot,” 20 percent say that their most important step was raising prices; 10 percent who believe energy costs increased “more than other costs” or “somewhat” passed on their higher costs. In contrast, 27 percent of the group who feel that energy increases were substantial took conservation steps; 37 percent who feel they were not unusual did as well. No obvious explanation exists for this surprising result.

Final Comments

Small-business owners meet cost increases and adjust to them with a variety of responses. The most

likely are absorbing an increase in the form of lower earnings or profits, reducing consumption of the goods/services increased, and raising selling prices. Employee layoffs, relative compensation reduction, or changes in business investment occur far less frequently unless they are the goods/services whose price is increasing. In that event they become a goods/services whose consumption is reduced. However, the frequency of each response changes with the circumstances. The size of the cost increase, the amount of notice small-business owners have before the increase goes into effect, and the goods/services increased strongly influenced the mix of responses employed.

The frequency that small-business owners report that they absorb cost increases is disturbing. Even under the most benign circumstances, a significant percentage report that they absorb cost increases in the form of lower earnings or profits. For example, when there is no notice of a small increase, more than half report earnings reductions. But absorbing cost increases cannot be sustained over the long-term unless a business is consistently getting more cost reductions than increases from its suppliers, or unless the firm's productivity constantly rises faster than the rate of cost increase. The substantial percentage of owners citing an earnings reduction response to cost increases, therefore, could theoretically be an indicator of positive or negative financial health. Since this data set contains no information on profitability, the question cannot be resolved here. Yet, it appears that owners of firms that are growing rapidly are much less likely to absorb cost increases while those with sales losses are more likely to do so. If growing sales substitute for financial health and declining sales the opposite, the most vulnerable firms are likely to suffer most from cost increases. Moreover, no matter what the financial health of the firm receiving the cost increase, absorbing a cost increase comes from the small-business owner's pocket.

Absorbing cost increases implies that small firms, at best, front the increased costs and distribute them among non-earnings-related responses as quickly as the owner's management skills and market conditions allow. Even if cost increases can eventually be passed through however, someone must pay the carrying charges and that "someone" is the small-business owner initially absorbing the cost. Not surprisingly, about 20 percent say that they are likely to take out a loan or draw down a credit line when experiencing a cost increase without notice. Borrowing smooths the transition; it usually allows them to pay the additional cost without serious disruption in normal activity. But borrowing is a cost increase on a cost increase. Moreover, the longer it takes the small-business owner to find a place to put the increased cost, the higher the financing costs.

Given these results, the reaction of small-business owners to the inflationary conditions of the 1970s and early 1980s was predictable. They were always behind cost increases. Even when they were able to pass them on (as many as 70 percent raised prices in one quarter according to *Small Business Economic Trends*), regular borrowing rose. Small-business managers needed to stay ahead of price increases, but many could not do it. Plunging profitability resulted and even those who survived often struggled. Today's low inflation environment is vastly different. Still, the fundamental management problem is similar. Small-business owners must remain "ahead of the curve" on prices or else absorb new costs. If they learn of pending increases long before their institution and if they are adjust to them quickly, owners put themselves in a virtuous upward, rather than a vicious downward, financial spiral.

A basic tenant in economics is that cost increases reduce consumption of the good/service whose price has been raised. Not surprisingly, the data here underscore that point. The more the cost of a good/service rises, the more often small-business owners first choose to make adjustments by reducing its consumption. Thus, as energy prices rise, energy conservation steps become more common; as payroll costs rise, employee-related steps, e.g., reduced employment or relative compensation, become more frequent. The surprise is that consumption reduction does not occur more often. A 15 percent payroll cost increase, a very large increase, yields less than one-third whose first step would be to take an employee-related measure. A five percent increase yields only 17 percent making their first step employee related. While it is clear that the first action taken is usually not the only action taken, a substantial portion of small-business owners do not meet a payroll increase with employee-related actions. At least in the short-term therefore, it appears that a surprisingly small portion of labor cost increases are passed back to employees. While these additional payroll costs may eventually be paid by employees through employee-related measures, they clearly do not pay for them immediately. A parallel occurs in energy.

Thirty-seven (37) percent of small employers noting energy cost increases reduced energy consumption as their most important response and 57 percent took action to conserve energy. In this case, little more than half took some action directly related to the cost of the good/service that was rising. It should again be noted that these were short-term responses. They did not include long-term responses, though short-term may be the only relevant time frame as energy costs have declined dramatically over the “long-term.”

It is difficult to overemphasize time as a factor affecting the decisions made in adjusting to cost increases. The data presented here underscore the importance of prior knowledge about pending cost rises. Advance notice or early discovery of new costs results in different choices being made than when there is no such knowledge. But what the data do not (and cannot) capture is the influence of time after receipt of the increase. Once choices are initially made to respond to cost increases, how does the mixture of choices change as time passes? This issue is critical considering the high percentage of small-business owners who feel that they initially absorb cost increases with lower earnings or profits. Owners simply cannot absorb cost increases as a routine matter. They must transfer them elsewhere in the long-term even when they absorb them in the short-term. How and when that happens remains an open question.

ADJUSTING TO COST INCREASES

(Please review notes at the table's end.)

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

1. Suppose you know that SIX MONTHS from now your payroll costs, i.e., the costs of wages AND benefits, are going to rise five percent. What is the most likely step that you would take to pay for this five percent payroll cost increase? Would you:

	1-9 emp	10-19 emp	20-249 emp	All Firms
1. Raise prices?	38.1%	37.0%	36.7%	37.8%
2. Lay-off some employees or not fill existing vacancies?	10.1	13.0	13.3	10.8
3. Absorb it with lower earnings or profits?	23.4	21.7	23.3	23.2
4. Freeze or cut employee wages or benefits?	5.9	10.9	6.7	6.6
5. Cut, eliminate, or delay business investment?	6.3	8.7	6.7	6.6
6. (Combination of steps)	1.0	–	3.3	1.2
7. (Nothing)	9.4	8.7	6.7	9.1
8. (Out of business/Sell the business)	0.7	–	–	0.6
9. (Increase business volume)	3.1	–	–	2.5
10. (Other)	1.0	–	3.3	1.2
11. (DK/Refuse)	0.7	–	–	0.6
Total	100.0%	100.0%	100.0%	100.0%
N	167	118	82	367

2. Suppose you know that SIX MONTHS from now your payroll costs, i.e., the costs of wages AND benefits, are going to rise fifteen percent rather than five percent. What is the most likely step that you would take to pay for this fifteen percent payroll cost increase? Would you:

	1-9 emp	10-19 emp	20-249 emp	All Firms
1. Raise prices?	37.2%	41.3%	33.3%	37.4%
2. Lay-off some employees or not fill existing vacancies?	18.6	19.6	23.3	19.1
3. Absorb it with lower earnings or profits?	11.6	10.9	3.3	10.8
4. Freeze or cut employee wages or benefits?	9.1	8.7	13.3	9.4
5. Cut, eliminate, or delay business investment?	8.8	8.7	6.7	8.6
6. (Combination of steps)	1.8	2.2	3.3	2.0
7. (Nothing)	6.0	4.3	3.3	5.5
8. (Out of business/Sell the business)	2.5	–	10.0	2.8
9. (Increase business volume)	0.4	2.2	–	0.6
10. (Other)	2.6	–	3.3	2.2
11. (DK/Refuse)	1.8	2.2	–	1.7
Total	100.0%	100.0%	100.0%	100.0%
N	167	118	82	367

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

3. Suppose again that you faced a five percent payroll increase, but instead of coming in six months, it would occur next week. What is the most likely step that you would take to pay for this cost increase? Would you:

1. Raise prices?	17.5%	19.6%	16.7%	17.7%
2. Lay-off some employees or not fill existing vacancies?	7.4	6.5	6.7	7.2
3. Absorb it with lower earnings or profits?	47.4	58.7	53.3	49.2
4. Freeze or cut employee wages or benefits?	6.7	4.3	3.3	6.1
5. Cut, eliminate, or delay business investment?	5.6	4.3	3.3	5.3
6. (Combination of steps)	0.4	–	–	0.3
7. (Nothing)	7.4	6.5	6.7	7.2
8. (Out of business/Sell the business)	1.1	–	–	0.8
9. (Increase business volume)	0.7	–	–	0.6
10. (Other)	1.1	–	–	0.9
10. (DK/Refuse)	2.9	–	3.3	2.5
Total	100.0%	100.0%	100.0%	100.0%
N	167	118	82	367

4. How likely is it that you would borrow or draw down on an existing line of credit to ease adjustment to these higher costs? Is it:

1. Highly likely?	4.5%	4.2%	6.7%	4.7%
2. Likely?	19.5	16.7	10.0	18.4
3. Not likely?	26.5	37.5	33.3	28.5
4. Not at all likely?	48.8	39.6	50.0	47.7
5. (DK/Refuse)	0.6	2.1	--	0.8
Total	100.0%	100.0%	100.0%	100.0%
N	167	118	82	367

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

5. Suppose your payroll cost increase was going to be fifteen percent next week rather than five percent? What is the most likely step that you would take to pay for this fifteen percent payroll cost increase that begins next week? Would you:

1. Raise prices?	18.2%	22.7%	20.7%	18.9%
2. Lay-off some employees or not fill existing vacancies?	18.5	15.9	20.7	18.9
3. Absorb it with lower earnings or profits?	26.2	34.1	24.1	27.0
4. Freeze or cut employee wages or benefits?	9.1	6.8	6.9	8.6
5. Cut, eliminate, or delay business investment?	9.8	6.8	6.9	9.2
6. (Combination of steps)	–	–	3.4	0.3
7. (Nothing)	4.5	2.3	3.4	4.2
8. (Out of business/Sell the business)	3.5	2.3	10.3	3.9
9. (Increase business volume)	–	–	–	–
10. (Other)	3.1	2.3	–	1.9
11. (DK/Refuse)	4.5	4.5	3.4	4.5
Total	100.0%	100.0%	100.0%	100.0%
N	167	118	82	367

6. How likely is it that you would borrow or draw down on an existing line of credit to ease adjustment to these higher costs? Is it:

1. Highly likely?	5.9%	8.3%	6.9%	6.3%
2. Likely?	17.5	18.8	13.8	17.4
3. Not likely?	30.1	37.5	31.0	31.1
4. Not at all likely?	45.1	33.3	48.3	43.8
5. (DK/Refuse)	1.3	2.1	--	1.4
Total	100.0%	100.0%	100.0%	100.0%
N	167	118	82	367

7. Approximately what percent of your total business expenses consists of payroll, i.e., the cost of wages and benefits? Would you estimate that your payroll constitutes _____ of total business expenses?

1. Less than 10 percent	11.5%	8.2%	3.2%	10.4%
2. 10% to less than 20 %	23.0	22.4	19.4	22.6
3. 20% to less than 30%	20.2	28.6	29.0	22.1
4. 30% to less than 40%	14.3	20.4	25.8	16.1
5. 40% to less than 50%	9.8	8.2	6.5	9.3
6. 50 percent or more	15.7	10.2	12.9	14.7
7. (DK/Refuse)	5.6	2.0	3.2	4.9
Total	100.0%	100.0%	100.0%	100.0%
N	167	118	82	367

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

8. How difficult is it for you currently to attract and keep qualified employees? Is it currently _____ to attract and keep qualified employees?

1. Very difficult	22.4%	21.3%	16.7%	21.8%
2. Somewhat difficult	31.1	27.7	30.0	30.6
3. Neither easy nor difficult	7.7	10.6	20.0	9.1
4. Somewhat easy	16.8	23.4	16.7	17.6
5. Very easy	20.3	14.9	16.7	19.3
6. (DK/Refuse)	1.7	2.1	--	1.1
Total	100.0%	100.0%	100.0%	100.0%
N	167	118	82	367

9. Suppose you know that SIX MONTHS from now your physical facilities costs, i.e., the costs of rent or mortgage, utilities and maintenance, are going to rise five percent. What is the most likely step that you would take to pay for this five percent payroll cost increase? Would you:

1. Raise prices?	39.0%	26.7%	32.6%	37.3%
2. Lay-off some employees or not fill existing vacancies?	6.1	10.0	9.3	6.8
3. Absorb it with lower earnings or profits?	32.6	46.7	32.6	33.7
4. Freeze or cut employee wages or benefits?	5.5	--	4.7	5.0
5. Cut, eliminate, or delay business investment?	5.8	13.3	11.6	7.0
6. (Combination of steps)	--	--	--	--
7. (Nothing)	3.5	3.3	4.7	3.7
8. (Out of business/Sell the business)	0.3	--	--	0.3
9. (Increase business volume)	--	--	--	--
10. (Other)	4.1	--	--	3.3
11. (DK/Refuse)	1.6	--	2.3	1.6
Total	100.0%	100.0%	100.0%	100.0%
N	183	82	120	385

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

10. Suppose you know that six months from now your physical facilities costs, i.e., the costs of your rent or mortgage, utilities and maintenance, are going to rise fifteen percent rather than five percent. What is the most likely step that you would take to pay for this fifteen percent payroll cost increase? Would you:

1. Raise prices?	39.8%	38.7%	43.9%	40.2%
2. Lay-off some employees or not fill existing vacancies?	16.5	16.1	17.1	16.5
3. Absorb it with lower earnings or profits?	11.3	6.5	12.2	11.0
4. Freeze or cut employee wages or benefits?	3.6	6.5	4.9	3.9
5. Cut, eliminate, or delay business investment?	10.0	16.1	9.8	10.5
6. (Combination of steps)	3.2	3.2	–	2.8
7. (Nothing)	1.3	3.2	2.4	1.6
8. (Out of business/Sell the business)	1.0	3.2	4.9	1.6
9. (Change locations)	5.8	3.2	2.4	5.2
10. (Other)	1.5	–	–	1.3
11. (DK/Refuse)	4.5	3.2	2.4	4.2
Total	100.0%	100.0%	100.0%	100.0%
N	183	82	120	385

11. Suppose again that you faced a five percent physical facilities cost increase, but instead of coming in six months, it would occur next week. What is the most likely step that you would take to pay for this cost increase? Would you:

1. Raise prices?	15.8%	18.8%	14.3%	15.8%
2. Lay-off some employees or not fill existing vacancies?	7.1	3.1	9.5	7.0
3. Absorb it with lower earnings or profits?	53.4	56.3	52.4	53.5
4. Freeze or cut employee wages or benefits?	4.2	3.1	2.4	3.9
5. Cut, eliminate, or delay business investment?	7.7	12.5	11.9	8.6
6. (Combination of steps)	0.3	–	–	0.3
7. (Nothing)	4.8	6.3	2.4	4.7
8. (Out of business/Sell the business)	0.3	–	2.4	0.5
9. (Change location)	–	–	–	–
10. (Other)	2.2	–	2.4	2.1
11. (DK/Refuse)	4.2	–	2.4	3.6
Total	100.0%	100.0%	100.0%	100.0%
N	183	82	120	385

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

12. How likely is it that you would borrow or draw down on an existing line of credit to ease adjustment to these higher costs? Is it:

1. Highly likely?	4.5%	9.4%	6.8%	5.2%
2. Likely?	14.4	18.8	15.9	14.9
3. Not likely?	27.9	28.1	34.1	28.6
4. Not at all likely?	51.6	43.8	40.9	49.7
5. (DK/Refuse)	1.6	–	2.3	1.5
Total	100.0%	100.0%	100.0%	100.0%
N	183	82	120	385

13. Suppose your physical facilities cost increase was going to be fifteen percent next week rather than five percent? What is the most likely step that you would take to pay for this fifteen percent physical facilities cost increase that begins next week? Would you:

1. Raise prices?	21.2%	26.7%	24.4%	22.0%
2. Lay-off some employees or not fill existing vacancies?	14.5	10.0	9.8	13.6
3. Absorb it with lower earnings or profits?	24.8	36.7	34.1	26.7
4. Freeze or cut employee wages or benefits?	3.9	3.3	2.4	3.7
5. Cut, eliminate, or delay business investment?	13.8	10.0	12.2	13.4
6. (Combination of steps)	0.9	–	2.4	1.2
7. (Nothing)	2.9	3.3	2.4	2.9
8. (Out of business/Sell the business)	1.9	3.3	2.4	2.1
9. (Change locations)	3.9	–	–	3.1
10. (Other)	5.7	3.3	4.8	5.5
11. (DK/Refuse)	6.4	3.3	4.8	6.1
Total	100.0%	100.0%	100.0%	100.0%
N	183	82	120	385

14. How likely is it that you would borrow or draw down on an existing line of credit to ease adjustment to these higher costs? Is it:

1. Highly likely?	5.8%	6.3%	11.6%	6.5%
2. Likely?	13.8	18.8	20.9	15.0
3. Not likely?	30.2	34.4	23.3	29.8
4. Not at all likely?	48.9	40.6	44.2	47.7
5. (DK/Refuse)	1.3	--	--	1.0
Total	100.0%	100.0%	100.0%	100.0%
N	183	82	120	385

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

15. Approximately what percent of your total business expenses consists of your firm's physical facilities, i.e., rent or mortgage, utilities and maintenance, etc.? Would you estimate that the cost of your physical facilities constitutes _____ of total business expenses?

1. Less than 10 percent	22.2%	28.1%	34.9%	24.1%
2. 10% to less than 20 %	30.5	34.4	23.3	30.1
3. 20% to less than 30%	24.1	25.0	18.6	23.6
4. 30% to less than 40%	8.0	3.1	7.0	7.5
5. 40% to less than 50%	1.6	3.1	2.3	1.8
6. 50 percent or more	6.8	3.1	2.3	6.0
7. (DK/Refuse)	6.8	3.1	11.6	7.0
Total	100.0%	100.0%	100.0%	100.0%
N	183	82	120	385

16. How do your current selling prices compare with the selling prices of your principal competitor? Are they _____ than your principal competitor's?

1. Much higher	0.5%	1.3%	--%	0.5%
2. Higher	8.4	12.8	12.2	9.2
3. About the same	59.6	60.3	63.5	60.1
4. Lower	23.1	19.2	16.2	22.0
5. Much lower	4.4	2.6	5.4	4.3
6. (DK/Refuse)	4.1	3.9	2.8	3.9
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	200	752

17. How competitive is the primary market in which your firm operates? Is it :

1. Extremely competitive?	33.8%	31.6%	41.9%	34.4%
2. Quite competitive?	23.3	29.1	27.0	24.3
3. Competitive?	22.3	19.0	18.9	21.6
4. Somewhat competitive?	11.2	13.9	9.5	11.3
5. Not too competitive?	8.5	6.3	2.7	7.7
6. (DK/Refuse)	0.8	–	--	0.7
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	200	752

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

18. Since the beginning of the year, have your total energy costs risen:

1. Significantly?	25.0%	27.5%	27.0%	25.5%
2. A lot?	12.5	13.8	10.8	12.5
3. More than other costs?	14.5	12.5	10.8	13.9
4. Somewhat?	23.7	22.5	31.1	24.3

5. Little or none?	22.4	21.3	17.6	21.8
6. (DK/Refuse)	1.8	2.5	2.7	2.0
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	200	752

19. Since the beginning of the year, what type of energy cost increase has impacted your business the most? Is it: (If costs have risen significantly, a lot, more than other costs or somewhat in Q#18.)

1. Diesel?	7.9%	6.7%	13.8%	8.4%
2. Natural gas?	22.5	21.7	19.0	22.1
3. Fuel oil?	3.3	1.7	5.2	3.3
4. Electricity?	31.1	31.7	31.0	31.2
5. Coal?	--	--	--	--
6. Gasoline?	33.3	35.0	29.3	33.1
7. (Other)	0.7	1.7	1.7	0.9
8. (DK/Refuse)	1.1	1.7	--	1.1
Total	100.0%	100.0%	100.0%	100.0%
N	263	151	158	572

20. What have you done to OFFSET the rising cost of energy? Have you: (If energy type indicated in Q#19.)

A. Raised selling prices?

1. Yes	27.4%	32.8%	33.3%	28.6%
2. No	71.9	67.2	64.9	70.7
3. (DK/Refuse)	0.7	--	1.8	0.7
Total	100.0%	100.0%	100.0%	100.0%
N	254	143	152	549

B. Laid off some employees or not filled existing vacancies?

1. Yes	12.1%	17.2%	17.9%	13.2%
2. No	87.9	82.8	82.1	86.8
3. (DK/Refuse)	--	--	--	--
Total	100.0%	100.0%	100.0%	100.0%
N	254	143	152	549

Employee Size of Firm

1-9 emp 10-19 emp 20-249 emp All Firms

C. Absorbed it with lower earnings or profits?

1. Yes	74.1%	77.6%	76.8%	74.8%
2. No	24.5	22.4	23.2	24.1
3. (DK/Refuse)	1.4	--	--	1.1
Total	100.0%	100.0%	100.0%	100.0%
N	254	143	152	549

D. Froze or cut employee wages and benefits?

1. Yes	13.2%	12.1%	14.3%	13.2%
2. No	86.5	87.9	85.7	86.6
3. (DK/Refuse)	0.2	--	--	0.2
Total	100.0%	100.0%	100.0%	100.0%
N	254	143	152	549

E. Cut, eliminated or delayed business investment?

1. Yes	27.4%	22.4%	26.8%	26.8%
2. No	72.4	77.6	71.4	72.8
3. (DK/Refuse)	0.2	--	1.8	0.4
Total	100.0%	100.0%	100.0%	100.0%
N	254	143	152	549

F. Reduced the total volume of energy used through conservation measures?

1. Yes	58.2%	58.6%	50.0%	57.4%
2. No	41.3	41.4	50.0	42.2
3. (DK/Refuse)	0.5	--	--	0.4
Total	100.0%	100.0%	100.0%	100.0%
N	254	143	152	549

Employee Size of Firm

1-9 emp 10-19 emp 20-249 emp All Firms

21. Which was the single most important step that you took to offset rising energy costs? Was it: (If at least one action specified in Q#20.)

1. Raising selling prices?	15.1%	22.2%	15.6%	15.9%
2. Laying-off some employees or not filling existing vacancies?	2.9	4.8	3.1	3.1
3. Absorbing them with lower earnings or profits?	31.7	36.5	48.4	33.9
4. Freezing or cutting employee wages or benefits?	2.5	1.6	1.6	2.3
5. Cutting, eliminating, or delaying business investment?	4.6	4.8	3.1	4.5
6. Reducing the total volume of energy used through conservation measures?	39.0	28.6	26.6	36.6
7. (Other)	1.9	1.6	1.6	1.8
8. (DK/Refuse)	2.3	--	--	1.8
Total	100.0%	100.0%	100.0%	100.0%
N	304	164	170	638

22. Do you expect that energy prices will rise or continue to rise throughout the remainder of the year?

1. Significantly	11.0%	10.1%	8.1%	10.7%
2. A lot	7.0	8.9	6.8	7.2
3. More than other costs	13.5	17.7	13.5	14.0

4. Somewhat	31.1	32.9	33.8	31.6
5. Little or none	32.3	27.8	35.1	32.1
6. (DK/Refuse)	5.0	2.5	2.7	4.5
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	200	752

23. How do you plan to compensate for those increases? Is it by: (If costs have risen significantly, a lot, more than other costs or somewhat in Q#22.)

1. Raising selling prices?	31.4%	23.4%	26.8%	30.0%
2. Laying off some employees or not filling existing vacancies?	2.9	6.4	7.3	3.8
3. Absorbing them with lower earnings or profits?	17.8	19.1	19.5	18.1
4. Freezing or cutting employee wages or benefits?	3.6	2.1	2.4	3.3
5. Cutting, eliminating, or delaying business investment?	9.7	10.6	4.9	9.3
6. Reducing the total volume of energy used through conservation measures?	23.6	25.5	24.4	23.9
7. (Nothing)	3.6	6.4	7.3	4.3
8. (Other)	5.5	4.2	2.4	5.1
9. (DK/Refuse)	1.9	2.1	2.4	2.0
Total	100.0%	100.0%	100.0%	100.0%
N	186	121	113	420

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

24. Since the beginning of the year, what business cost increases have impacted your business the most?
 Has it been:

1. Employee health insurance?	17.4%	25.3%	26.4%	19.1%
2. Goods, supplies and materials?	15.4	17.7	15.3	15.6
3. Employee wages and salaries?	12.5	13.9	19.4	13.4
4. Energy, including gasoline and electricity?	40.3	34.2	31.9	38.9
5. Facilities costs, such as rent or mortgage, maintenance and repair?	8.2	7.6	4.2	7.7
6. (DK/Refuse)	6.2	1.3	2.8	5.3
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

DEMOGRAPHICS

D1. Is your primary business activity:

1. Construction?	10.0%	17.5%	8.1%	10.6%
2. Manufacturing?	8.2	10.0	12.2	8.8
3. Wholesale?	5.9	3.8	5.4	5.6
4. Retail?	22.4	25.0	25.7	23.0
5. Transportation?	4.2	3.8	6.8	4.4
6. Communication?	2.0	2.5	1.4	2.0
7. Financial Services?	10.0	3.8	4.1	8.8
8. Services?	30.9	30.0	32.4	31.0
A. Non-professional, e.g., lodging, auto repair, garages, recreation	(20.0)	(32.0)	(30.4)	(22.3)
B. Professional, e.g., health, legal, education, engineering	(38.9)	(32.0)	(30.4)	(37.3)
C. Business, e.g., advertising, mail, employment agencies, computer services, security, equipment rental	(26.5)	(16.0)	(13.0)	(24.0)
D. Personal, e.g., laundries, beauty shop, photography, funeral services, child care	(8.1)	(20.0)	(21.7)	(0.7)
E. (Other)	(6.4)	--	(4.3)	(5.6)
9. Agriculture, forestry, fishing?	5.4	3.8	1.4	4.8
10. (Other)	0.3	--	1.4	0.4
11. (DK/Refuse)	0.7	--	1.4	0.6
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

D2. Over the last two years, have your real volume sales:

1. Increased by 30 percent or more?	7.7%	12.5%	17.3%	9.2%
2. Increased by 20 to 29 percent?	15.0	18.8	13.3	15.3
3. Increased by 10 to 19 percent?	30.2	25.0	30.7	29.7
4. Changed less than 10 percent one way or the other?	26.9	25.0	22.7	26.3
5. Decreased by 10 percent or more?	13.7	12.5	10.7	13.3
6. (DK/Refuse)	6.5	6.3	5.3	6.4
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

D3. Is this business operated primarily from the home, including any associated structures such as a garage or a barn?

1. Yes	22.6%	7.5%	2.7%	19.0%
2. No	76.3	92.5	95.9	79.9
3. (DK/Refuse)	1.2	--	1.4	1.1
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

D4. How long have you owned or operated this business?

1. < 6 years	27.8%	26.3%	19.2%	26.8%
2. 6-10 years	18.9	15.0	17.8	18.4
3. 11-20 years	28.6	30.0	30.1	28.9
4. 21-30 years	13.0	17.5	12.3	13.4
5. 31 years+	10.0	8.8	17.8	10.7
6. (DK/Refuse)	1.7	2.5	2.7	1.9
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

D5. What is your highest level of formal education?

1. Did not complete high school	2.8%	1.3%	1.4%	2.5%
2. High school diploma/GED	17.9	16.3	9.6	16.9
3. Some college or an associates degree	20.4	23.8	24.7	21.2
4. Vocational or technical school degree	3.7	1.3	1.4	3.2
5. College Diploma	34.1	43.8	43.8	36.1
6. Advanced or professional degree	19.2	12.5	19.2	18.5
7. (DK/Refuse)	1.9	1.3	--	1.5
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

Employee Size of Firm
1-9 emp 10-19 emp 20-249 emp All Firms

D6. Please tell me your age.

1. <25	0.8%	--%	2.7%	0.9%
2. 25-34	9.4	17.5	12.2	10.5
3. 35-44	27.9	27.5	29.7	28.1
4. 45-54	31.3	35.0	31.1	31.6
5. 55-64	17.9	13.8	16.2	17.3
6. 65+	9.4	2.5	5.4	8.2
7. (DK/Refuse)	3.3	3.8	2.7	3.3
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

D7. What is the zip code of your business?

1. East (zips 010-219)	19.6%	17.5%	19.2%	19.4%
2. South (zips 220-427)	20.8	16.3	23.3	20.6
3. Mid-West (zips 430-567, 600-658)	22.5	32.5	24.7	23.8
4. Central (zips 570-599, 60-898)	19.3	20.0	20.5	18.5
5. West (zips 900-999)	17.8	13.8	12.3	16.8
Total	100.0%	100.0%	100.0%	100.0%
N	352	200	200	752

D8. What were your gross sales in the most recent calendar or fiscal year?

1. <\$100,000	16.6%	2.5%	2.7%	13.7%
2. \$100,000 - \$249,999	14.4	6.3	4.1	12.5
3. \$250,000 - \$499,999	14.0	8.8	5.4	12.6
4. \$500,000 - \$999,999	13.2	18.8	12.2	13.7
5. \$1 million - \$4.9 million	12.7	30.0	37.8	17.0
6. \$5 million - \$9.9 million	2.2	5.0	8.1	3.1
7. \$10 million or more	0.8	1.3	14.9	2.3
8. (DK/Refuse)	26.1	27.6	14.9	25.2
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

D9. Sex

Male	74.9%	75.0%	74.3%	74.9%
Female	25.1	25.0	25.7	25.1
Total	100.0%	100.0%	100.0%	100.0%
N	350	200	202	752

Table Notes

1. All percentages appearing are based on weighted data.
2. All “N’s” appearing are based on unweighted data.
3. Data are not presented where there are fewer than 50 unweighted cases.
4. ()s around an answer indicate a volunteered response.

WARNING – When reviewing the table, care should be taken to distinguish between the percentage of the population and the percentage of those asked a particular question. Not every respondent was asked every question. All percentages appearing on the table use the number asked the question as the denominator.

DATA COLLECTION METHODS

The data for this survey report were collected for the NFIB Education Foundation by the executive interviewing group of The Gallup Organization. The interviews for this edition of the *Poll* were conducted between June 18 and July 25, 2001 from a sample of small employers. "Small employer" was defined for purposes of this survey as a business owner employing no fewer than one individual in addition to the owner(s) and no more than 249.

The sampling frame used for the survey was drawn at the Foundation's direction from the files of the Dun & Bradstreet Corporation, an imperfect file but the best currently available for public use. A random stratified sample design was employed to compensate for the highly skewed distribution of small-business owners by employee size of firm (Table A1). Almost 60 percent of employers in the United States employ just one to four people meaning that a random sample would yield comparatively few larger small employers to interview. Since size within the small-business population is often an important differentiating variable, it is important that an adequate number of interviews be conducted among those employing more than 10 people. The interview quotas established to achieve these added interviews from larger, small-business owners were arbitrary but adequate to allow independent examination of the 10-19 and 20-249 employee size classes as well as the 1-9 employee size group.

Table A1
SAMPLE COMPOSITION UNDER VARYING SCENARIOS

Employee Size of Firm	Expected from <u>Random Sample*</u>		<u>Obtained from Stratified Random Sample</u>			
	<u>Interviews Expected</u>	<u>Percent Distri- bution</u>	<u>Interview Quotas</u>	<u>Percent Distri- bution</u>	<u>Completed Interviews</u>	<u>Percent Distri- bution</u>
1-9	593	79	350	47	350	47
10-19	82	11	200	27	200	27
20-249	75	10	200	27	202	27
All Firms	750	100	750	101	752	101

*Sample universe developed from special runs supplied the NFIB Education Foundation by the Bureau of the Census (1997 data).