

RISING HEALTH CARE COSTS

THE 'TIPPING POINT' FOR SMALL BUSINESS?

In his 2002 book *The Tipping Point*, author Malcolm Gladwell proposed a theory about why changes in our society often happen suddenly and unexpectedly. As new information and data slowly accumulate and then more quickly snowball, knowledge spreads exponentially and people act accordingly. What was once a small trend can become a sensation. And what was once a small concern for just a few can become a major crisis.

"UNTIPPY" SMALL BUSINESS ENTREPRENEURS

That bedrock of the American economy that we collectively refer to as "small business" is famously stable.

For example, the third wave of the CIT Small Business Outlook survey, conducted in May 2005, shows that despite a litany of vaguely troubling U.S. macroeconomic news — big companies that still aren't loosening the B2B purse strings, persistent fears of "stagflation," slower-than-expected job growth, and volatile oil prices — small business entrepreneurs continue to report results that compare favorably to the country's general economic performance. Back in September 2004, 70 percent of survey participants said that their company had performed well over the previous 12 months, in comparison with the overall economy. The latest survey shows that a still very healthy 69 percent have the same answer.

A POTENTIAL TIPPING POINT

But just as water has its boiling point, small business, too, has its tipping point, that particular moment when many entrepreneurs — seemingly overnight — decide all at once that providing health care insurance for employees is too expensive. This is a real, tangible problem for the survey participants. In fact, 60 percent say that the rising costs of health care constitute a "crisis" and already debilitate economic growth in



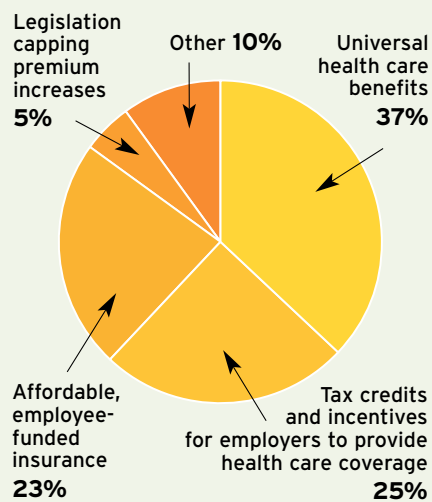
this country. As further evidence of how severe the problem has already become, consider that more than one-third (37 percent) of the entrepreneurs who participated in the survey believe that the best solution to the problem is universal health care benefits, a remedy that was considered quite extreme just a few years ago.

Before we delve into how spiraling health costs are affecting the specific survey participants, let's take a look at the general economic polling data from the latest survey.

ABOUT THE SAMPLE

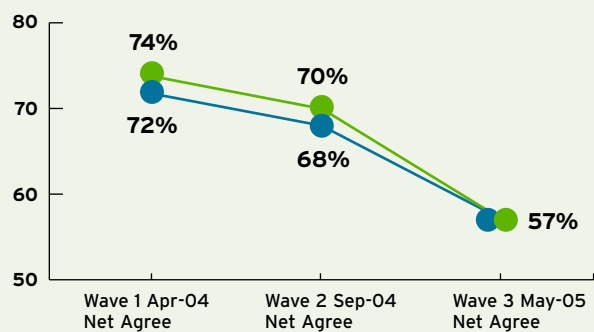
This phase three survey, like the previous two, was conducted jointly by BusinessWeek research services and CIT, a

Best Health Care Solutions



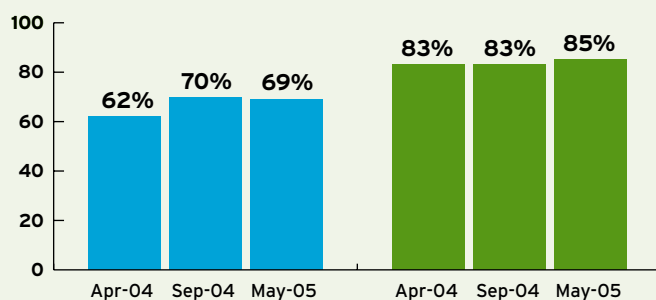
Small Business' Outlook on U.S. Economy

- U.S. companies will increase their spending levels over the next 12 months
- I'm confident about the future of the U.S. economy



Small Businesses Are Holding Their Own

- Performed Well Relative to the Economy
- Expected Increase In Sales



Fortune 500 commercial and consumer finance company. The first phase of the survey, back in April 2004, focused on companies and their need for capital. The second phase dealt with how companies view the process of growing their businesses. This phase concerns how companies manage employee health care costs. Like the previous two surveys, most of those who participated generate the majority of their revenue (64%) from other businesses.

A HARD-WON RESILIENCY

While small businesses have been doing better than the overall economy, their collective confidence about the greater U.S. economy, as it turns out, is not immune to glum business page headlines.

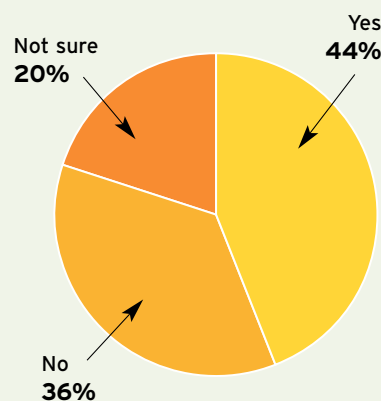
Survey participants report a fairly sharp decline in confidence about our economy's future. Back in April 2004, 72 percent of those surveyed were confident about the future of the U.S. economy, and in September a still very respectable 68 percent expressed similar confidence. In the latest survey, however, 57 percent of those surveyed are confident about the future of our economy. In addition, only about one in five expects an improved economy and business environment to increase sales revenues. There is also quite a drop-off in the

number of companies who believe that U.S. companies will increase their spending levels over the next 12 months, from 70 percent in the September 2004 survey to 57 percent in the latest survey.

And yet, an unmistakable optimism pops from the data. In the view of many of the survey participants, the positive outlook for their own company clearly outweighs any uncertainty about the macroeconomic situation.

For instance, 49 percent of those responding in the latest survey plan on

Q: Is your business currently growing fast enough to cover increases in health care insurance premiums?



expanding into new markets and new customer bases, compared to 41 percent in the September 2004 survey. Fully three-quarters of companies believe that now is a good time for firms to invest in their organizations, and 47 percent expect to increase spending on advertising and marketing in the near future, the same percentage as in the September 2004 survey.

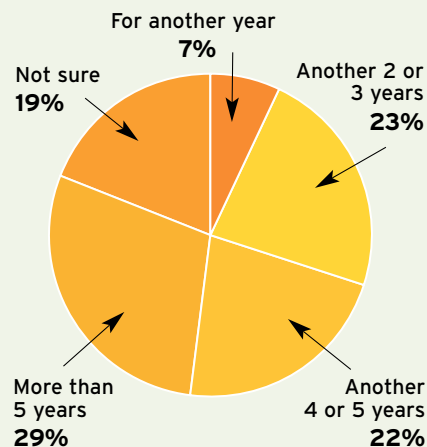
The good news, then, is that in the rough times of the past few years, it's clear that small businesses developed a hard-won resiliency that is now serving them well. The bad news is that the rising cost of health care is one issue that could be much tougher to manage.

THE BASIC ISSUE

The basic problem is one that has been at the forefront of public policy debates for at least a decade. The cost of U.S. health care itself, as well as the cost of health care insurance, is rising much faster than the rate of inflation. In the context of small business, these costs are rapidly outstripping the ability of firms to increase revenues.

First, a pair of overarching facts: Three-quarters of the survey participants provide health care benefits to their employees, and 78 percent of those companies pride themselves on offering coverage they believe is as good as or better than that provided by bigger companies. And they can't be accused of not preparing adequately for the issue of employee health care. In fact, fully 56 percent say that they factored into their business plan the rising cost of employee health care insurance premiums. But no preparation could

Q: How many years into the future do you think your business can sustain a level of growth to cover increases in health care insurance premiums?



forecast how rapidly health insurance costs are spiraling up.

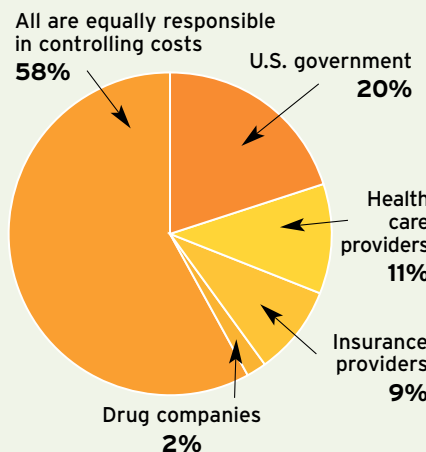
In the latest survey, we ask how long companies can continue to grow their businesses to cover expected increases in health care insurance premiums. Slightly more than half (52 percent) say five years or less. Just 29 percent think they can keep up with premium increases for more than five years. It's little wonder the participants were generally not confident in their ability to keep pace; 42 percent of them expect premiums to rise by more than 10 percent in 2006.

The survey participants are very clear about the root causes of the problem. Eighty-six percent say that small business' lack of bargaining power with insurance companies is a major obstacle to managing employee health care insurance. A slightly lower percentage of participants, 82 percent, mention the bureaucratic nature of insurance providers as a major obstruction. Just about half name cumbersome paperwork, a lack of price controls in the health care industry, and employees' unrealistic expectations of health care insurance as major obstacles.

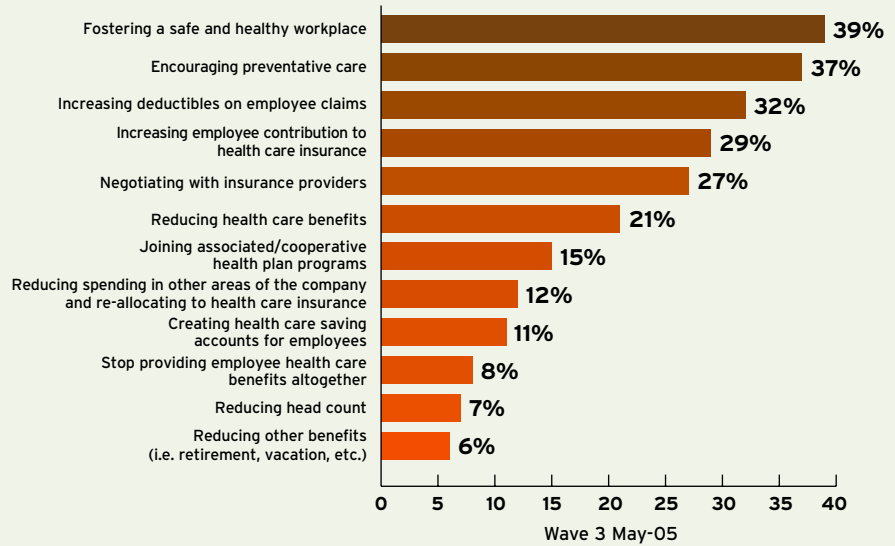
WHOSE RESPONSIBILITY IS IT?

We wanted to know the participants' thoughts on whose responsibility it is to fix the problem. While the U.S. government is named most by those participants who chose to single out one entity (20 percent), the vast majority of the survey participants (58 percent) think that four different parties – the U.S. government, health care providers, insurance providers, and pharmaceutical companies – are equally

Q: Where do you feel the majority of the responsibility lies in controlling health care costs within the U.S.?



How Small Businesses Are Managing Health Care Costs



responsible for controlling the cost of health care.

The participants choose a number of solutions when asked, "What do you think is the best solution to managing the impact of health care on the U.S. economy?" Their single most popular answer is: "Universal health care benefits." Coming in a distant second place is tax credits and incentives for employers to provide health care coverage. Affordable, employee-funded insurance comes in third.

WHAT COMPANIES ARE ALREADY DOING

It's clear that many companies are forging ahead without the help they want so much. When asked about what their company has done to manage employee health care costs, 39 percent of survey participants mention fostering a safe and healthy workplace, 37 percent are encouraging preventative care, 32 percent are increasing deductibles on employee claims, and 29 percent are relying on increased employee contributions to health care insurance.

CONCLUSION: A STRONG INCENTIVE TO KEEP PROVIDING HEALTH INSURANCE

There remains a very strong incentive for small businesses to provide affordable employee health care insurance. Their ability to hire and retain talented professionals, as well as the mental and physical well being of current employees, depends on it. Indeed, the silver lining of

the survey is that very few participants (8%) have stopped providing benefits altogether as an effective way to manage health care costs.

But until the major players forge a more comprehensive solution, the data suggests that employees will have to share more of the burden of their health care insurance costs. Not a satisfactory development, but one that — for now — will allow the nation's small businesses to continue to power our economy.

SURVEY METHODOLOGY

BusinessWeek Research Services (a division of the BusinessWeek marketing department) conducted the CIT Small Business Outlook jointly with CIT, a *Fortune 500* commercial and consumer finance company that works with global industry leaders and small businesses alike. Representatives from 453 companies participated in the latest survey. The sample was drawn from the BusinessWeek Market Advisory Board, and Insight-Express, a market research firm in Stamford, Connecticut, conducted the online survey.

In the latest survey, there were fewer than five employees in almost 37 percent of the companies surveyed, while 8 percent had more than 100 employees. Revenues of participating companies ranged from under \$500,000 to \$15 million.

To view The 2005 CIT Small Business Outlook survey, visit CIT.com.