



Small Business Outlook: San Francisco Bay Area Winter 2005-2006

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San Francisco-Oakland-San Jose:

- Six Counties: Alameda, Contra Costa, Marin, San Francisco, San Mateo and Santa Clara.
- Population: 6 million (16% of Calif. total)
- Total Personal Income: \$195 billion (2003, also 16% of California total)
- Per capita personal income:
\$46,072 vs. \$33,415 for all of California
(2003 personal income/population).

Retail sales are growing...

- ...but at a slower rate than in the rest of the state.
- California second quarter 2004 retail sales increased by 9% from year earlier levels, but increased by a lower 8% in San Francisco, 5% in San Mateo and 7% in Santa Clara counties.
- Retail sales growth was a bit slower in the third quarter of 2004, compared to 2003, with California continuing to outpace the Bay Area:



San Francisco-Oakland-San Jose, CA

2000-2004 Third Quarter Retail Sales

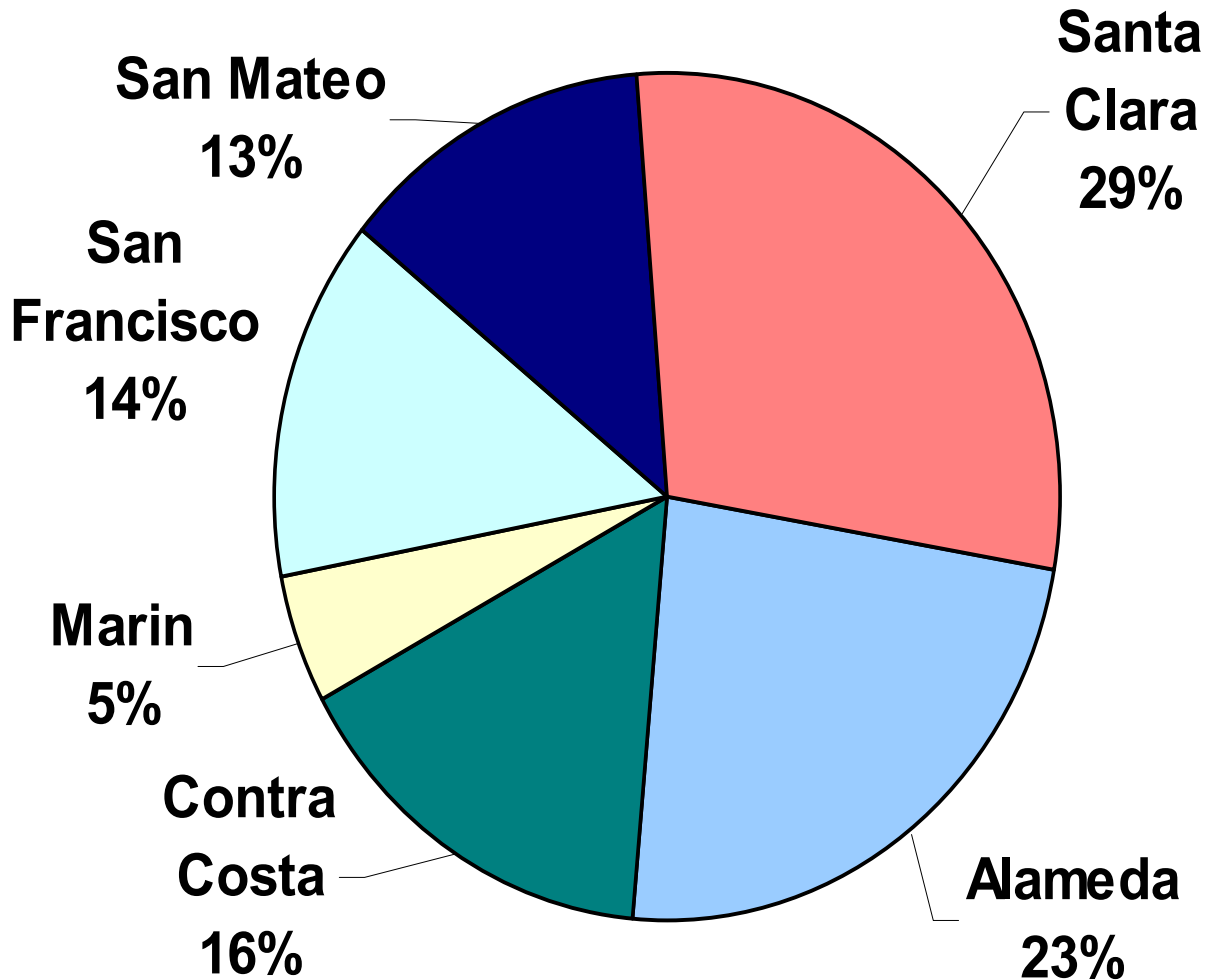
(thousands of dollars)

| | Total Quarterly Sales | Percent change from Prior Year | California | Percent change from Prior Year |
|------|-----------------------------|--------------------------------------|------------|--------------------------------------|
| 2000 | 15,955,692 | 15.7% | 72,724,706 | 12.0% |
| 2001 | 14,442,633 | -9.5% | 72,624,171 | -0.1% |
| 2002 | 14,435,821 | 0.0% | 76,778,986 | 5.7% |
| 2003 | 14,738,815 | 2.1% | 82,645,000 | 7.6% |
| 2004 | 15,338,651 | 4.1% | 88,187,769 | 6.7% |

SOURCE: California State Board of Equalization.



San Francisco-Oakland-San Jose, CA: Retail Sales by County - 3rd Quarter 2004



The local economy is growing:

- Preliminary estimates for 2005 retail sales from the Association of Bay Area governments estimate stronger retail sales growth for 2005, over 2004's positive numbers. Further growth is forecast for 2006.
- Bay Area small businesses are finally feeling the positive effects of increased sales and a steady economic recovery.

NFIB's Small Business Survey:

- 55% of small businesses in Northern California experienced “good” to “very good” market conditions in November.
 - This is up 10 percentage points, from 45%, in May 2005.
 - Profits have been good to very good for 42% of the firms surveyed, up from 37% in May 2005.
 - 64% see good to very good sales prospects over the next several months.
 - National Federation of Independent Business, www.nfib.com

Despite good prospects, confidence in the markets has fallen, input prices are rising:

- Fewer than one in four (24%) of Northern California small business owners sees market conditions improving.
- Half (53%) of business owners surveyed say that have paid more for the goods and services they purchase over the past 3 months, while only 26% have increased their selling prices.



Slow employment growth will continue:

- Employment is increasing, but slowly: In November, a smaller proportion of small businesses reported job openings (17%) than in May (19%).
- Half (53%) of Northern California small business owners believe they can increase sales by 10% without hiring more employees or purchasing new equipment.



| Small Businesses in the San Francisco-Oakland-San Jose MSA | | | | |
|---|---|-----------------------------|----------------|-----------------------------|
| | Employment at Firms with 1 to 99 Employees | | | |
| | 1997 | | 2002 | |
| | Number | Percent of Total | Number | Percent of Total |
| San Francisco, MSA¹ | 353,721 | 37.9% | 352,610 | 37.5% |
| San Jose, MSA² | 277,633 | 31.1% | 278,961 | 31.2% |
| Oakland, MSA³ | 330,771 | 38.6% | 351,773 | 36.2% |
| Total no. of firms, 1 to 99 employees in 2002: | | | | 113,510 |
| Total no. of firms, 100 to 499 employees in 2002: | | | | 4,423 |
| Total no. of firms, >500 employees in 2002: | | | | 5,014 |
| 1. Includes Marin, San Francisco and San Mateo counties. | | | | |
| 2. Includes Santa Clara County. | | | | |
| 3. Includes Alameda and Contra Costa counties. | | | | |
| SOURCE: U.S. Bureau of the Census | | | | |



Employment Growth Returned in 2005:

| | Small Business,* 1997-2002 | 1997- 2002^ | 2002- 2004^ | 2005^ |
|---|---|------------------------|------------------------|--------------|
| | (average annual percent change) | | | |
| San Francisco, MSA | -0.1% | 0.1% | -2.1% | 0.8% |
| San Jose, MSA | 0.1% | -0.5% | -3.1% | -0.4% |
| Oakland, MSA | 1.2% | 1.9% | -1.0% | 1.1% |
| *1 to 99 employees. | | | | |
| ^Payroll employment growth for all firms, regardless of size, excluding the self-employed. | | | | |

NOTE: San Jose payroll employment data shows a drop in 2005, but the household survey, which includes the self-employed, shows a 0.9% increase.

Venture Capital Investment Remains Strong

- 2005 3rd venture capital investing in Bay Area firms increased by 25% compared to the 3rd quarter of 2003.
- This represents a rebound from a 2nd quarter 2005 slump: VC investing during the 2nd quarter was 19% lower than in 2004.
- Year-to-date VC investing is up just 0.2% over the first 3 quarters of 2004.

VC investing occurs in small firms:

- Software and telecommunications received the largest amount of VC investment, followed by semiconductors & biotechnology (3rd Q. 2005).
- The majority of VC investment occurs in Santa Clara County: payroll employment is expected to improve in 2006.
- Slow growing labor market ensures that small firms will continue to have access to talented workers.

Some risks going forward:

- Bay Area consumers are not as upbeat as they were in the summer:
 - Half of Bay Area consumers surveyed by the Survey and Policy Research Institute in September thought that business conditions were worse in the U.S., compared to only 36% who thought so in July.
 - Inflationary expectations have risen: Fully 85% Bay Area consumers expect general prices to rise, versus 72% in July.

But Bay Area residents are upbeat about their own finances:

- Almost half (47%) expect their own incomes to be higher next year
 - That's up from 41% in July.
 - Average employee earnings remain high, an average of \$70,278 per year in Santa Clara County in 2004, \$62,353 in San Francisco County and \$62,500 in San Mateo County.
 - The average for California was \$44,641.



Consumer pessimism may prove short-lived:

- While crude oil and natural gas prices remain high, gasoline prices have plummeted from over \$3 per gallon in September-October.
- Gasoline prices averaged \$2.57 per gallon in San Francisco and \$2.60 per gallon in San Jose on November 15, 2005.
 - Gasoline prices have fallen further in December, meaning consumers have more holiday spending money than previously thought.

Small Businesses looking good:

- "This is a challenging time for big corporations," said John Hofmeister, who runs the U.S. operations of Shell Oil Co. The modern feeling, he said, is 'big is bad.'" *
- *From: "Survey: Executives are corrupt: Fresh scandals fuel increasing disfavor with corporations," Claudia H. Deutsch, *New York Times*, Friday, December 9, 2005.

Small Businesses looking good:

- As large businesses cut back on benefits and health care contributions, small businesses will be able to better compete for employees.
- Many Bay Area small businesses are now experiencing a steady growth in orders, after several years of tough times.



2006: A good for small business?

- Business sales and activity should continue to grow into 2006, as the Bay Area recovers from the jobs recession of 2001-2004.
- Slow hiring by the large firms, outside of health care and Santa Clara County's Internet search portal firms, should make hiring easier for small business.
- Small business normally generate 60 to 80 percent of net new jobs, according to the U.S. Small Business Administration.

The Industries to Watch in 2006:

- Housing demand will likely slow, as demand is satiated and interest rates rise.
- Construction and finance, a source of job growth over the past 2 years, may begin to shed jobs.
- Health care will continue to grow, as will biotechnology.
- Business services may stage a recovery, as local businesses grow and off-shoring slows.