Special Report

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The digital imperative for U.S. small businesses

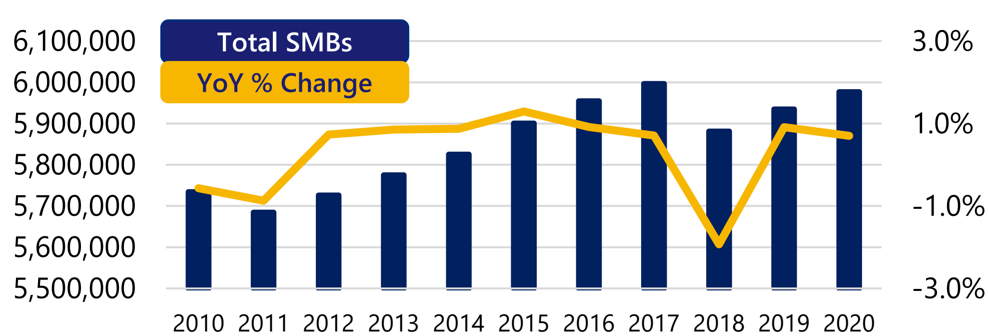
2020 was a challenging year for everyone, including small businesses. While the challenges proved too great for some small businesses, others got their start by identifying and creating new opportunities from the challenges. Last year, there were 41,776 more small businesses than there were in 2019,[1] despite the immense damage done by the pandemic. However, coming out of the pandemic, these new and existing small businesses that survived the pandemic now face yet more hurdles in labor shortages, costs associated with COVID regulations, and rapidly rising prices for inputs. Digital solutions can help small businesses overcome these macroeconomic factors while meeting consumers' growing appetite for online shopping and other digital alternatives. In this report, we discuss the supply and demand factors that are pushing small businesses to greater digitization to address the new market realities.

How small businesses responded to the pandemic

COVID-19 caused many small businesses to change how they do business as lockdowns prevented many face-to-face interactions with both suppliers and customers.

- Online transactions at small businesses increased
- Online transactions on small business cards increased
- Nearly two-thirds of small businesses have made a technology investment since COVID began

Fig. 1: Despite the pandemic, the number of small businesses increased in 2020



Source: Visa Business and Economic Insights and Small Business Administration

Key Points:

The number of small businesses reporting a technology investment doubled in 2020.[2] Without innovating, small businesses run risk of being left behind

Nearly 80 percent of small businesses use Enterprise Resource Software to streamline their processes[3]

55 percent of U.S. consumers will shop online whenever possible[4]

Supply and demand issues accelerate digital adoption

Small businesses across the nation welcomed wide-spread reopening following vaccine deployment, but also faced higher material input costs, expenses related to COVID protocol compliance (e.g. PPE) and wages as a result of labor shortages. These higher costs are compressing profit margins for small businesses, which is forcing them to cut costs and innovate wherever possible.

The supply side

The COVID-19 pandemic interrupted the global supply chain in a way not seen in the modern era, producing the lowest inventory-to-sales ratio on record in March of this year.[5] This major supply chain disruption continues to today in the U.S. At the same time, large-scale fiscal stimulus programs, vaccine deployments, and roll backs on COVID restrictions rapidly released pent-up consumer demand that took suppliers by surprise and exacerbated the problem. Labor shortages in the transportation industry further hampered U.S. supply chains, leading to a rapid rise in prices for both producers and consumers. This flowed through to the inputs many small businesses rely on. According to the September NFIB COVID-19 survey of small businesses, 90 percent of small businesses reported that supply chain disruptions had impacted their business, with half of all respondents saying that the impact was significant.[6] According to the same survey, just over two-thirds of small businesses anticipated these disruptions to continue impacting their business for six months or more. The recent surge in inflation should stay with us well into 2022, which will compress margins going forward if businesses cannot implement solutions to drive further efficiencies and keep costs under control.

Inflation pressures are persisting longer than expected

Fig. 2: Producers are passing along higher costs (SA, YoY percent change in PPI* vs. CPI)**

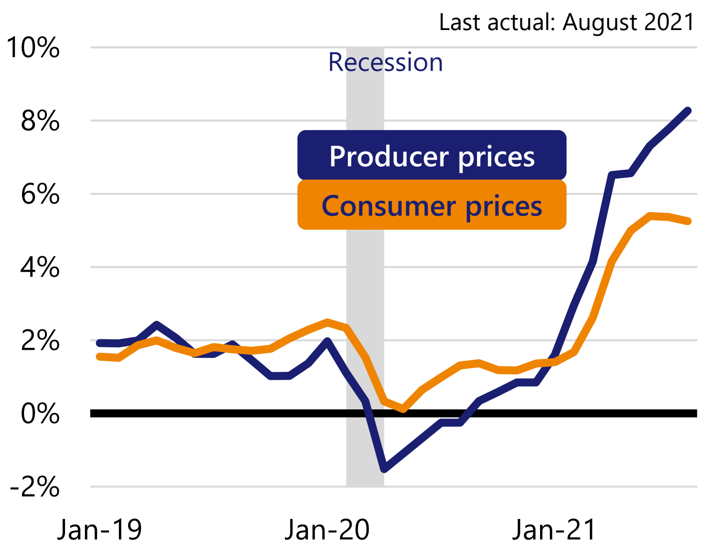
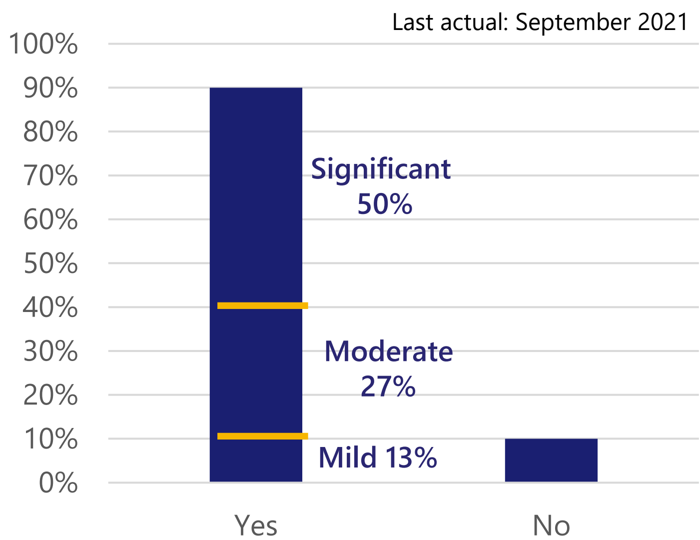


Fig. 3: Are supply chain disruptions impacting your business?



Source: Visa Busine Sources: Visa Business and Economic Insights, U.S. Department of Labor ,U.S. Department of Commerce and NFIB Covid-19 Small Business Survey, September 2021. *PPI=Producer Price Index for Final Demand **CPI=Consumer Price Index ss and Economic Insights and VisaNet

Beyond input price increases, small businesses have had to invest more resources to comply with protocols and consumer preferences around COVID-19 safety. These investments include PPE equipment, sanitizers, barriers in restaurants, masks and gloves. While the exact cost of these measures is hard to estimate, a Washington Post survey of attorneys general and financial departments across the U.S. found that consumers in 29 states had filed 510 complaints of coronavirus-related surcharges.[7] Many more small businesses are likely to have increased prices without explicitly charging consumers for the added costs. Depending upon the type of small business, these costs could be quite onerous. Small grocery stores, for example, operate on very tight margins. According to a McKinsey report, the cost to small grocers to cover additional labor and cleaning products was estimated at 1 percent of their revenues.[8] These costs add yet more hurdles for small businesses to overcome if they are to survive.

Labor is one of the biggest issues facing small businesses during this recovery. Two recent NFIB surveys illustrate this point, with nearly 10 percent of small businesses saying their biggest problem was the cost of labor,[9] while two-thirds faced some kind of labor shortage and 27 percent reported a severe labor shortage.[10] In response, 77 percent of small businesses said they increased wages to fill the open positions. Some of the current labor shortage is expected to subside following the expiration of enhanced unemployment insurance benefits; however, the lack of childcare options for many potential applicants and former small business employees is also preventing a return to normal staffing levels. The September NFIB COVID-19 survey found that 29 percent of small businesses have had at least one employee quit due to a lack of childcare options, and 18 percent have had difficulty hiring applicants due to childcare challenges. As long as the labor market remains this tight, small businesses will struggle to keep their doors open.

While many small businesses have considered increasing compensation or offering bonuses or other benefits to overcome the labor shortage, these measures only compound their existing costs related to inputs and COVID-19 compliance. Many small businesses have already increased prices (44 percent) or plan to increase prices (49 percent) to help offset the costs. But there is a limit to what they can do if they want to remain competitive with other small businesses or large businesses, which usually have the advantage of economies of scale[11] that small businesses do not have. Another path forward to minimize these costs by investing in labor and material saving technology. While this on its' own should incentivize further innovations among small businesses, they are also feeling this pressure on the demand side.

Most small businesses are facing staffing shortages

Fig. 4: Is your business currently experiencing a staffing shortage? (Percent of firms)

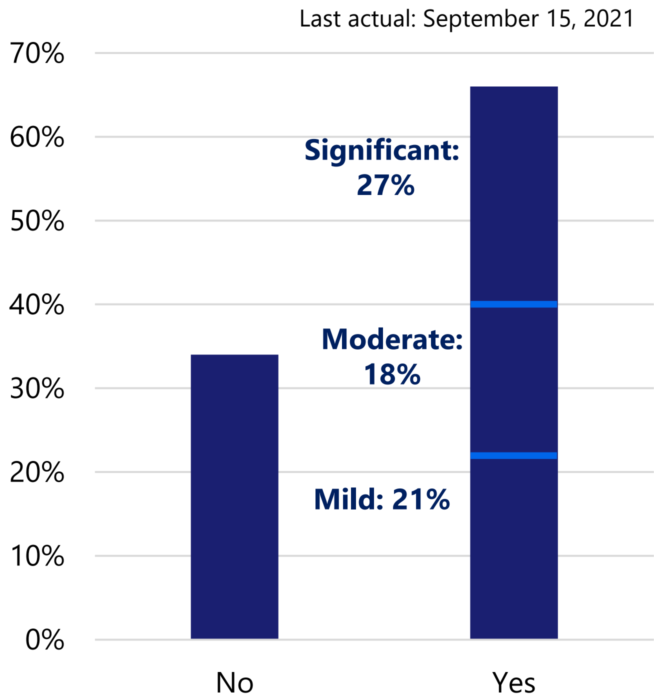
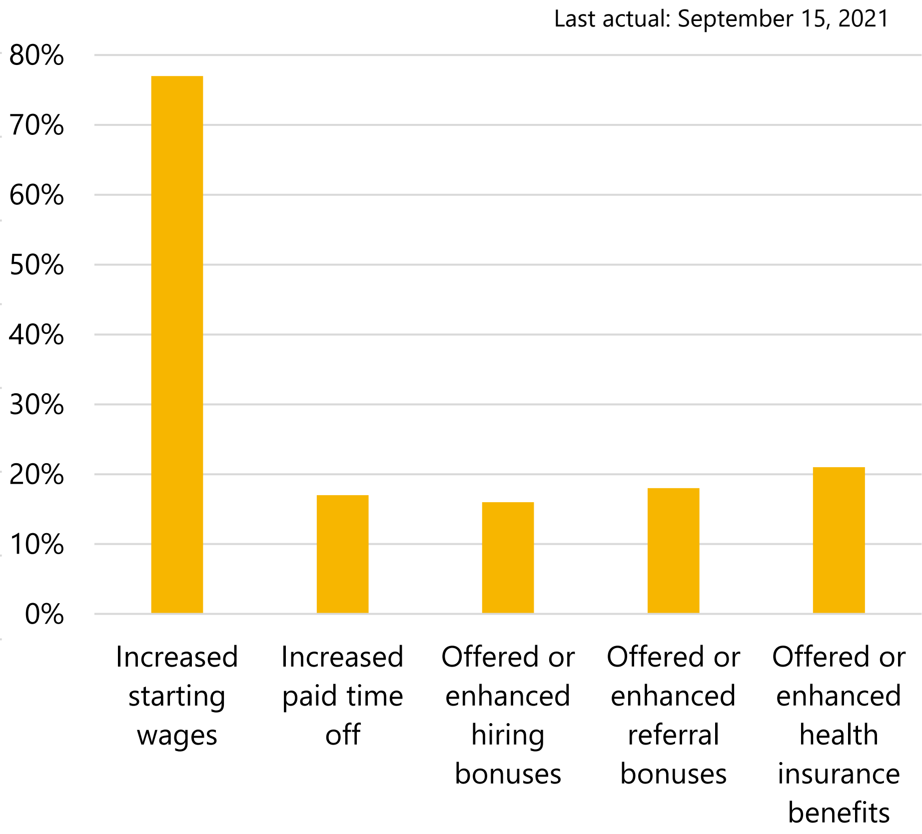


Fig. 5: What adjustments have you made to attract applicants for open positions (percent of firms)?



Sources: Visa Business and Economic Insights and NFIB Covid-19 Small Business Survey, September 2021

The demand side

The pandemic forced the closure of many traditionally in-person stores and a shift by many small businesses to expand their online presence. However, consumers aren't in any rush to change their online shopping habits back as life returns to normal. According to the Influential Shopper survey conducted by SAP and the Economist Intelligence Unit in September 2020, 61 percent of consumers said they would maintain a similar level of online spending once restrictions ended.[12]

Additionally, the fifth edition of the Visa Back to Business survey found that 55 percent of U.S. consumers will shop online whenever possible.[13] Furthermore, consumers also expect payment technology to be effortless, with 42 percent of those surveyed by Visa saying they will be using contactless payments and 54 percent expecting brick-and-mortar retail stores to accept contactless cards as payment whenever possible.[14] These survey results are important for small businesses, as they reveal a permanent shift in consumers' stated preferences and expectations.

Customers' actual behavior is also changing. The share of payment volume (PV) and transactions at small businesses with an online presence surged during the pandemic, according to our analysis of VisaNet data. Yet, even after restrictions loosened, that share remained higher than it was pre-pandemic. This is significant— as small businesses that are not positioned to sell products or services online will be at a disadvantage even after all pandemic restrictions are lifted and life is back to normal. In order to meet the changing preferences of consumers, small businesses must invest resources to bolster their online sales capacity or contactless payment options to remain competitive. Labor saving technology is therefore not only important in terms of driving efficiencies and keeping down costs, but also important to meeting consumer needs.

Small businesses are investing resources to meet changing customer preferences

Fig. 6: Increased or planning to increase sales prices (Net percent of firms)

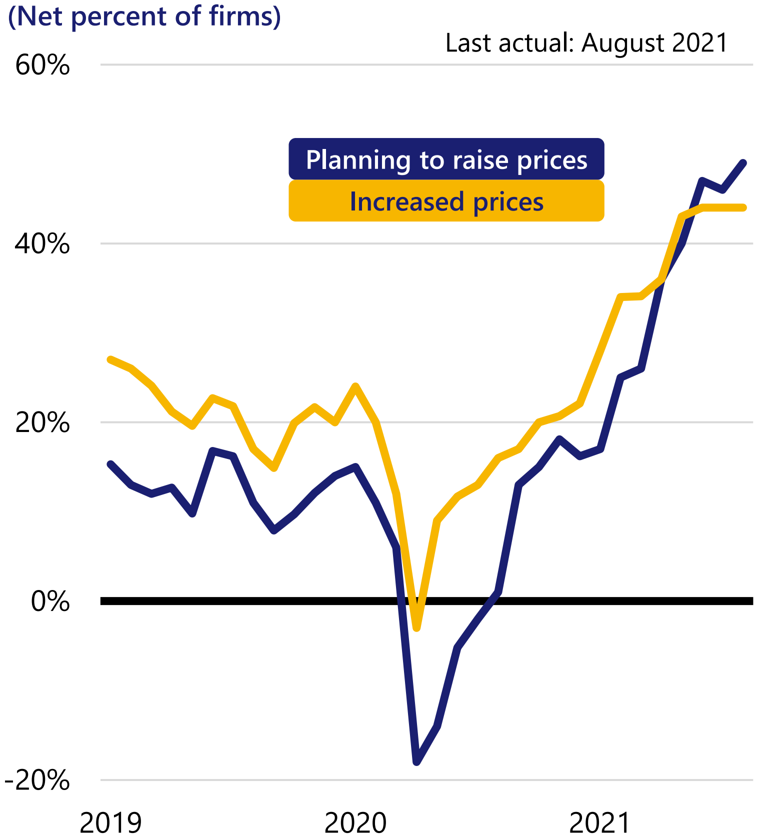
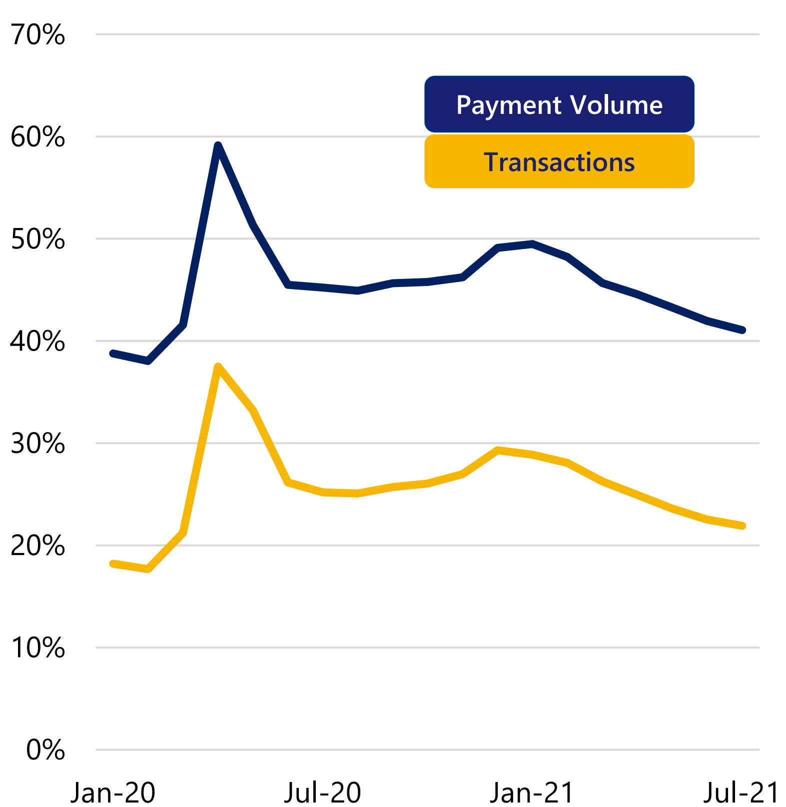


Fig. 7: Online payment volume and transaction share at SMBs (Jan. 2020-July 2021)



Sources: Visa Business and Economic Insights and ECI 2021 State of SMB Digital Transformation Survey Report

Digitization driving small business efficiencies

The pandemic has pushed small businesses to invest more heavily in technology. Labor and material input-saving technology can help drive efficiencies and keep costs under control—with one-third of small businesses in a recent survey saying they have introduced new technology to enhance productivity during the current labor shortage.[15] In another survey, the share of small businesses saying they had invested in technology in the past nine months doubled in the first quarter of 2021 compared to the first quarter of 2020.[16] Additionally, of the 64 percent of all small businesses surveyed that made a technology investment in the past nine months, 76 percent had increased their technology investment by 25 percent or more. Small businesses are recognizing that to compete they must invest in technology solutions. Those who are not making these investments run the risk of falling behind by either failing to adequately meet customer expectations or running inefficient processes that could make them less profitable than competitors.

Consumer-facing digital solutions

Many small businesses recognize the need to digitize and are actively exploring the best ways to do it. The most critical investment areas they see as necessary to meet consumer expectations include contactless or mobile payment acceptance (48 percent), payment acceptance via mobile device and untethered to point-of-sale security (46 percent), and accepting QR-based payments (21 percent).[17] Contactless payment and acceptance, as well as ordering and paying for restaurant bills via QR code, were widely adopted practices during the pandemic that are likely to remain after all restrictions are lifted. Firms that forego investing in new technologies will both fail to meet customers' needs and put the business at a distinct disadvantage compared to the many other small businesses making these investments. Another technology investment small businesses feel will be important is allowing installments for online payments (23 percent). Installment payments have been associated with raising the average ticket size for merchants, increasing the sale conversion rate, and building loyalty to the merchant. Consumers (particularly those under 40) are becoming more accustomed to paying for big ticket items in installments, so not investing in this space represents a loss of opportunity for firms to reach consumers in their prime spending years.[18]

Investment in technology doubled in response to COVID

Fig. 8: Did you make an investment in technology in the past 9 months? (Percent of respondents)

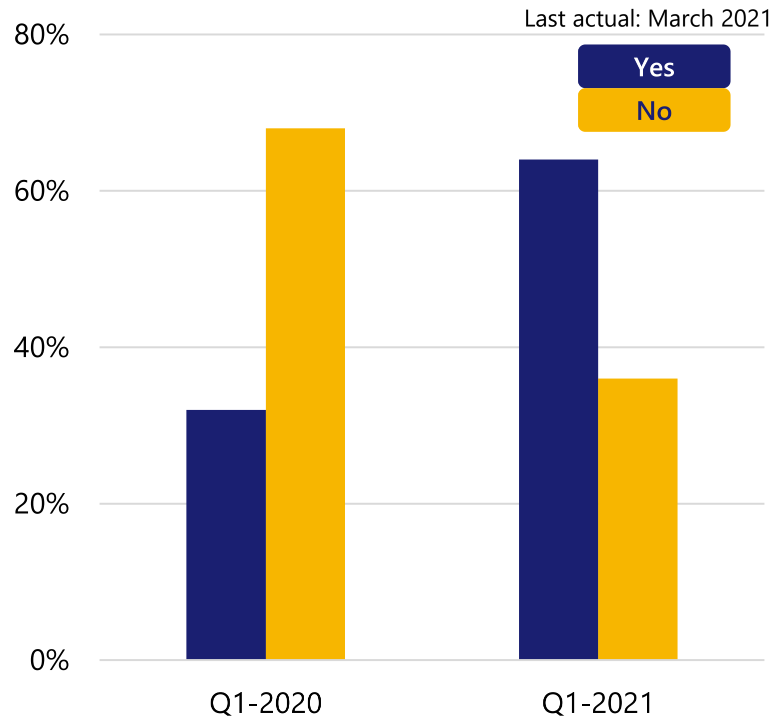
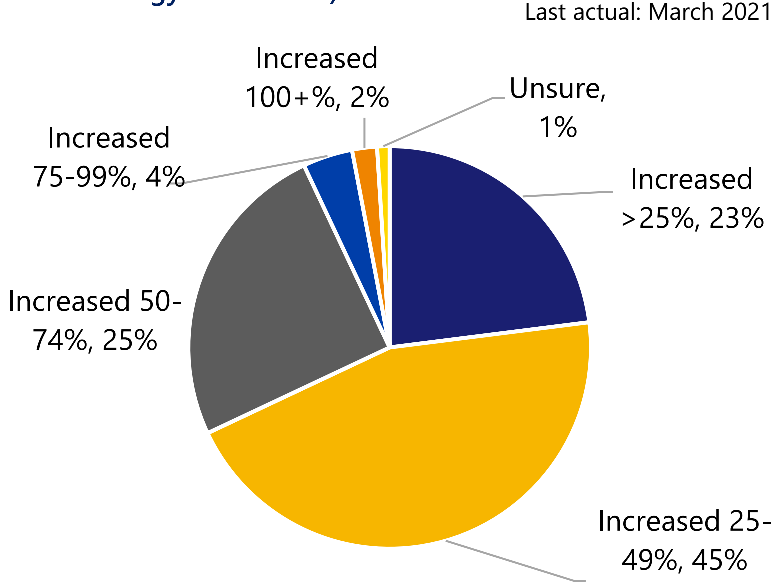


Fig. 9: How much did you increase investments in technology? (Percent of respondents that increased technology investment)



Sources: Visa Business and Economic Insights and ECI 2021 State of SMB Digital Transformation Survey Report
*LBM = Lumber and building materials

Operating technology investments

Small businesses are also innovating by doing their own payments and banking online. The share of small business owners that use online banking increased 10 percentage points to 88 percent from 2019 to 2020, while those that use mobile banking jumped 16 percentage points to 86 percent during the same period.[19]

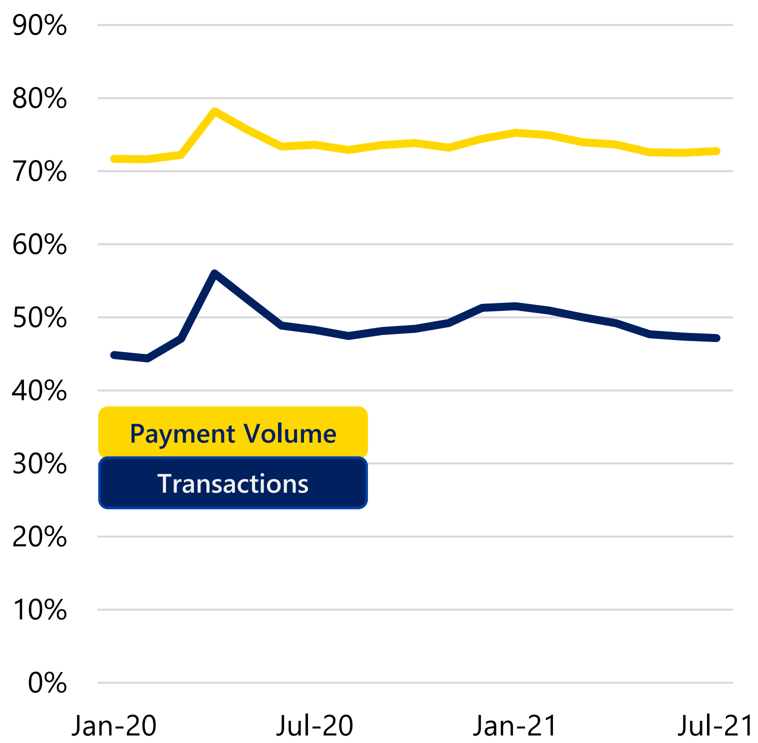
In 2020, firms were also more likely to use cards for paying rent, utilities and membership fees, according to the survey. Where once they paid via check, the pandemic forced them to look at digital options. Being able to make payments instantly over the internet or via mobile app rather than 'snail mail' is not only more reliable, but also more efficient for firms to better time their payments. This allows small businesses to maintain adequate funding in their accounts to cover their payments, especially at a time when margins are being compressed from cost increases.

The shift of small businesses to online and mobile banking has also coincided with their increased use of cards for online purchases. Even pre-pandemic, over 40 percent of transactions and more than two-thirds of money spent on small business cards was online, according to our analysis of VisaNet data. As of July, close to half of the transactions on small business cards were online and more than 70 percent of the money spent on small business cards was online.

One of the most important ways in which small businesses can save money on labor and material costs is to invest in technology that reduces these costs. One essential tool in achieving this during the pandemic (and likely even afterward) is enterprise resource planning software (ERP). Over half of small businesses that use enterprise resource planning (ERP) software were able to reduce manual effort and paperwork, streamline workflow and automate processes.[20] This means less reliance on labor and materials at a time when those costs are eating up a growing amount of small business budgets.

Despite the pandemic ending, customers and small businesses still like paying online

Fig. 10: Online payment volume and transaction share by SMBs (Jan. 2020-July 2021)



Sources: Visa Business and Economic Insights and VisaNet.

The risk of being left behind

While the pandemic and the resulting supply chain disruptions and labor shortages may have been the initial impetus for businesses large and small to implement new digital solutions, the digital landscape is unlikely to go back to the pre-pandemic normal. Consumers are expecting to transact more online and use contactless payments when buying goods and services in person. Small businesses may be nimbler than their larger counterparts, allowing them to pivot their strategy to a much more technology-based approach, but they often have fewer resources than larger companies to make those needed investments.

Therefore, it is imperative that small businesses find cost-effective solutions that enable them to deploy new technologies. Furthermore, it is incumbent upon issuers to help small businesses identify and employ the technologies most useful to their specific business. Labor shortages and material cost increases have had very negative impacts on small businesses, which has made labor- and material-saving digital innovations that much more important for them. Without these innovations, small businesses run the risk of being left behind in an increasingly digital world.

Footnotes

[1] Census Bureau and Small Business Administration

[2] The ECI 2021 State of SMB Transformation Survey

[3] ECI 2021 State of SMB Digital Transformation Survey

[4] "The Visa Back to Business Study 5th Edition." Visa Global Small Business and Consumer Insights (September 2021)

[5] Census Bureau

[6] National Federation of Independent Businesses Covid-19 Small Business Survey, September 2021

[7] "Companies are charging hidden 'covid fees' to make up for lost profits. They may be illegal." The Washington Post. Denham, Hannah (February 5, 2021). https://www.washingtonpost.com/road-to-recovery/2021/02/05/coronavirus-fees-pandemic-business/

[8] "US small-business recovery after the COVID-19 crisis." McKinsey & Company. Dua, Andre; Mahajan, Deepa; Oyer, Lucienne and Ramaswamy, Sree (July, 7, 2020) https://www.mckinsey.com/industries/public-and-social-sector/our-insights/us-small-business-recovery-after-the-covid-19-crisis

[9] NFIB Small Business Optimism Survey, August 2021.

[10] NFIB COVID-19 survey of small businesses, September 2021.

[11] Economies of scale are the cost advantages that enterprises obtain due to their scale of operation and are typically measured by the amount of output produced. A decrease in cost per unit of output enables an increase in scale.

[12] "The Influential Shopper Survey Report." The Economist Intelligence Unit and SAP. (September 2020)

[13] "The Visa Back to Business Study 5th Edition." Visa Global Small Business and Consumer Insights (September 2021)

[14] "The Visa Back to Business Study 4th Edition." Visa Global Small Business and Consumer Insights (June 2021)

[15] September NFIB COVID-19 survey of small businesses

[16] The ECI 2021 State of SMB Transformation Survey

[17] Visa Back to Business Survey

[18] "Understanding the Evolving Point of Sale Industry." TransUnion, LLC. Pagel, Liz

[19] Mercator Small Business Payment Insights, 2020. Reville, Peter

[20] ECI 2021 State of SMB Digital Transformation Survey

Accessibility Notes

Fig. 1 – Bar chart showing total number of small businesses combined with a line chart (right axis) overlay that shows the year-over-year (YoY) change in that number (left axis) by year from 2010 to 2020. The chart begins in 2010 with 5.73M small businesses, which was a -0.57 percent change from the previous year, and ends in 2020 with 5.98M small businesses, representing a 0.7 percent change from the previous year. The number of small businesses ranged from a low of 5.68M in 2011 and a high of 5.99M in 2017, while the smallest YoY change in small businesses was -1.9 percent in 2018 and the largest YoY change is 1.3 percent in 2015.

Fig. 2 – Line chart showing the seasonally adjusted YoY change in the producer price and consumer price indexes on a monthly basis from January 2019 to August 2021. The consumer price index begins at 1.55 percent and ends at 5.25 percent with a high of 5.39 percent in June 2021 and a low of 0.12 percent in May 2020. The producer price index begins at 1.92 percent and ends at 8.27 percent in August 2021, which is also the high of the series. The low of the series is -1.52 percent in April 2020.

Fig. 3 – Bar chart showing the proportion of small businesses that have had their business impacted by the supply chain disruption, with 90 percent of small businesses answering yes and 10 percent answering no. On the yes bar there are lines indicating the proportion of how impacted their business was, with 50 percent saying significant, 27 percent saying moderate, and 13 percent saying mild.

Fig. 4 – Bar chart showing the proportion of small businesses that are experiencing a staffing shortage. 66 percent of small businesses answered yes, while 34 percent answered no. On the yes bar there are lines indicating the proportion of how impacted their business was, with 27 percent saying significant, 18 percent saying moderate, and 21 percent saying mild.

Fig. 5 – Bar chart showing what small businesses experiencing a staffing shortage have done in response. From left to right, 77 percent answered "increased starting wages", 17 percent said "increased paid time off", 16 percent said "offered or enhanced hiring bonuses", 18 percent said "offered or enhanced referral bonuses", and 21 percent said "offered or enhanced health insurance benefits.

Fig. 6 – Line chart showing the net percentage of small businesses answering yes to the question of whether they have increased prices and the percentage of small businesses answering yes to the question of whether they plan to increase prices on a monthly basis. The net percentage of small businesses indicating that they have increased prices starts at 27 percent in January 2019 and ends at a series high of 44 percent in August 2021, with the series low of -3 percent in April 2020. The net percentage of small businesses indicating that they plan to raise prices starts at 15.3 percent in January 2019 and ends at a series high of 49 percent in August 2021, with the series low of -18 percent in April 2020.

Fig. 7 – Line chart showing the proportion of payment volumes and transactions at small businesses that were made online on a monthly basis. The percentage of payment volume spent online at small businesses starts at series low of 38.8 percent in January 2020 and ends at 41.1 percent in July 2021, with the series high of 59.1 percent in April 2020. The percentage of transactions online at small businesses starts at series low of 18 percent in January 2020 and ends at 22 percent in July 2021, with the series high of 37 percent in April 2020.

Fig. 8 – Bar chart showing the proportion of small businesses that did or did not make a technology investment in the past nine months, comparing the responses from Q1-2020 (left) to Q1-2021 (right). In Q1-2020 32 percent of small businesses said they had made a technology investment in the past nine months and 68 percent said no. In Q1-2021 64 percent of small businesses said they had made a technology investment in the past 9 months and 36 percent said no.

Accessibility Notes

Fig. 9 – Pie chart showing the proportion of small businesses that increased their technology investment and by how much they increased their technology investment. 1 percent were unsure, 23 percent increased their investment by less than 25 percent, 45 percent increased their investment by 25 to 49 percent, 25 percent increased their investment by 50 to 74 percent, 4 percent increased their investment by 75 to 99 percent, and 2 percent increased their investment 100 percent or more.

Fig. 10 – Line chart showing the proportion of payment volumes and transactions on small business cards that were made online on a monthly basis. The percentage of payment volume spent online at small businesses ranges from a series low of 71.1 percent in January 2020 and ends at 72.7 percent in July 2021, with the series high of 78.2 percent in April 2020. The percentage of transactions online at small businesses starts at 44.8 percent in January 2020 and ends at 47.2 percent in July 2021, with the series low of 44.4 percent in February 2020 and series high of 56 percent in April 2020.

Forward Looking Statements

This report may contain forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995. These statements are generally identified by words such as "outlook," "forecast," "projected," "could," "expects," "will" and other similar expressions. Examples of such forward-looking statements include, but are not limited to, statements we make about Visa's business, economic outlooks, population expansion and analyses. All statements other than statements of historical fact could be forward-looking statements, which speak only as of the date they are made, are not guarantees of future performance and are subject to certain risks, uncertainties and other factors, many of which are beyond our control and are difficult to predict. We describe risks and uncertainties that could cause actual results to differ materially from those expressed in, or implied by, any of these forward-looking statements in our filings with the SEC. Except as required by law, we do not intend to update or revise any forward-looking statements as a result of new information, future events or otherwise.

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