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Small Business Checkpoint

Ending 2023 on a good note – 5 themes

18 December 2023

Key takeaways

- Small businesses appear to be ending 2023 in fairly good shape despite growing financial headwinds. We highlight five themes that we think are critical to the health of small businesses as we head into the new year: 1) revenue, 2) operating costs, 3) debt condition, 4) alternative credit, and 5) the sectoral variation.
- Revenue is highly dependent on US consumer spending, which has moderated since the start of the year. At the same time, operating expenses remain elevated, which is squeezing profit margins, as measured by the small business account inflow-to-outflow ratio, per Bank of America internal data.
- The good news is balance sheet conditions remain healthy for small businesses. For example, while credit card debt is rising, the overall debt-to-net worth ratio remains low according to the Fed. And these businesses can turn to alternative lending sources as banks tighten standards. Among sectors, healthcare continues to see the fastest payment growth as demand persists.

Small Business Checkpoint is a regular publication from Bank of America Institute. It aims to provide a real-time assessment of small business spending activities and financial well-being, leveraging the depth and breadth of Bank of America's proprietary data. Such data is not intended to be reflective or indicative of, and should not be relied upon as, the results of operations, financial condition or performance of Bank of America

Throughout 2023, small businesses remained in fairly good shape but have been navigating growing financial headwinds. As a result, the Small Business Optimism Index, published by the National Federation of Independent Business, has remained at low levels (Exhibit 1). Here, we highlight five themes that we think are critical to the health of small businesses and worth paying attention to as we head into the new year.

#1 Revenue slowing on consumer spending moderation

Small business revenue is highly dependent on the state of the US consumer because consumer spending directly translates into revenues. As we have discussed in our Consumer Checkpoint series, US consumer spending has moderated since the start of the year but remains resilient by historical standards. This can also be seen in Exhibit 2: total consumer spending was up around 5% year-over-year (YoY) on a nominal basis in October 2023, still elevated, but down from around 8% YoY growth rate at the beginning of the year.

Exhibit 1: Small Business Optimism index

Optimism among small businesses has remained at low levels throughout 2023

Source: National Federation of Independent Businesses

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Exhibit 2: Personal consumption expenditure (%YoY)

Total consumer spending was up around 5% YoY on a nominal basis in October 2023

Source: Bureau of Economic Analysis

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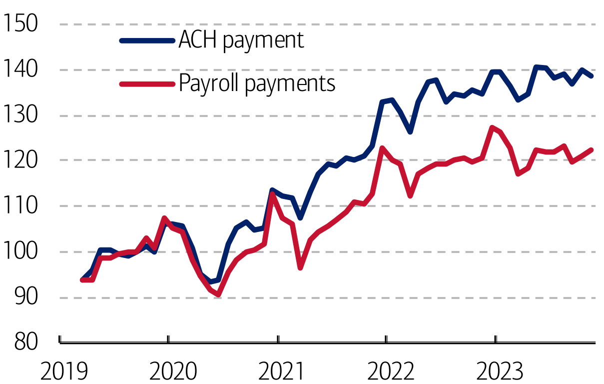
#2 Elevated operational costs are squeezing profit margins

Typically, Automated Clearing House (ACH) payments capture a significant portion of small business operating expenses, such as rent or payroll payments. Since the beginning of 2023, Bank of America internal data has shown a general increase in payroll payment levels, in line with the overall positive hiring reports from the Bureau of Labor Statistics (BLS). As discussed in our October Small Business Checkpoint, we are seeing signs of small business hiring growth outpacing that of larger businesses in recent months.

However, over the year, there has been a continued divergence between ACH and payroll payments per Bank of America internal data (Exhibit 3). This suggests that, despite a growth in payroll, other expenses are driving up ACH payment levels as well. Therefore, elevated ACH payments could point to higher operating costs, which would be a headwind to small businesses' profits, as measured by the account inflow-to-outflow ratio per Bank of America internal data (Exhibit 4).

Exhibit 3: ACH and payroll payment per client (index, 2019=100, 3-month moving average)

Higher payroll and other operating expenses have been driving up ACH payments



Source: Bank of America internal data

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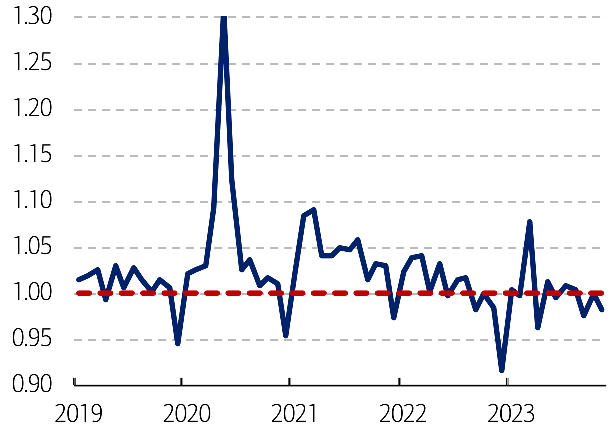
Exhibit 4: Small business account inflow-to-outflow ratio

The latter half of 2023 has seen inflow-to-outflow ratios below 1



Source: Bank of America internal data

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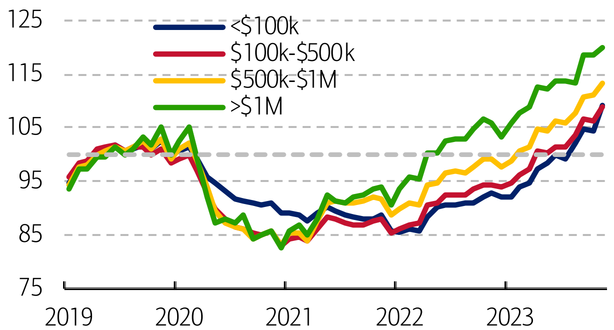
#3 Debt is rising, but the balance sheet is healthy overall

As we discussed in last month's Small Business Checkpoint, more small businesses appear to have been using credit cards as a source of financing this year, with an increasing portion of balances carrying interest as financial pressures build. As Exhibit 6 shows, the average Bank of America small business credit card balance rose throughout the year, but the degree of increase varies across business revenue tiers. For those small businesses with annual revenue greater than $1 million, the average credit card balance as of November 2023 was 20% higher than its 2019 average, the largest increase across revenue tiers (Exhibit 5). On the flip side, for the smallest firms, those with annual revenue less than $100k, the latest credit card balances were 9% higher than 2019 levels per Bank of America internal data.

Exhibit 5: Average small business credit card balance by business annual revenue tiers, according to Bank of America internal data (index, 2019 annual average=100 for each revenue tier)

Small businesses with annual revenue greater than $1 million are seeing higher increases in credit card balances



Source: Bank of America internal data. Balances are non-seasonally adjusted end of period values

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Exhibit 6: Ratio of bank loans to net worth for nonfinancial noncorporate businesses (%, quarterly data through 2Q 2023)

Ratio of bank loans to net worth for nonfinancial noncorporate businesses remains low by historical standards

Source: Federal Reserve. Note: nonfinancial noncorporate businesses include sole proprietorships and limited partnerships, which are mostly small businesses.

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While rising credit card balances could raise some concerns, we note three reasons to be less pessimistic. First, the biggest rise in credit card balances is seen among businesses in the highest annual revenue tiers, which typically have greater financial buffers. Second, inflation has increased over 20% since 2019, as measured by the Consumer Price Index (CPI), so the inflation-adjusted credit card balance is comparable to or even lower than 2019 levels across business annual revenue tiers. Lastly, the ratio of total bank loans, including credit card loans, and net worth for nonfinancial noncorporate businesses - most of which are small - remains at historically low levels. This suggests to us that the overall balance sheet conditions are healthy for small businesses.

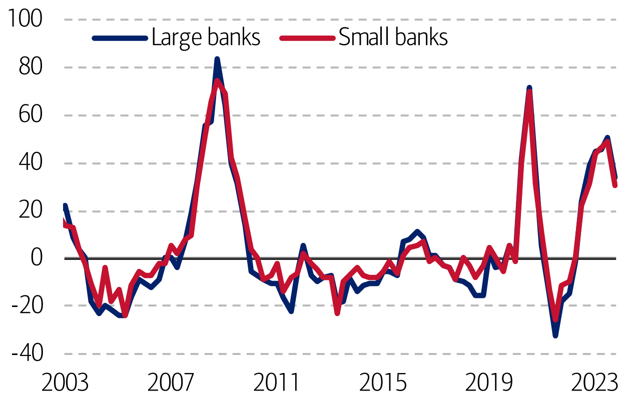
#4 Accessing alternative credit

With the rapid increase of interest rates and regional US bank failures earlier in the year, there has been a meaningful tightening of credit conditions. As shown by the Senior Loan Officer Opinion Survey (SLOOS), the net percentage of surveyed banks that were tightening commercial and industrial (C&I) loans to small firms surged in the first three quarters of the year before easing slightly in 4Q. Note that a positive reading means there are more banks tightening standards than easing them. Even with the slight easing, the current levels are comparable to prior recession periods (2000 and 2008).

Interestingly, despite credit conditions tightening for small businesses, our previous analysis suggests small business loan financing – as measured by the average amount of loan disbursement that is deposited into small business client accounts, per Bank of America internal data – has not slowed materially over the past year. Why might that be? In our view, while it is becoming harder for small businesses to access a bank loan, they have been turning to institutional lenders (i.e. private equity) or alternative lenders (i.e. fintech companies) for financing. This can be shown by the increased loan approval rates for these two sources, according to data from Biz2Credit (Exhibit 8).

Exhibit 7: Net percentage of banks tightening commercial and industrial (C&I) loans to small firms: large banks vs. small banks

The net percentage of banks tightening lending conditions has eased as of late



Source: Federal Reserve

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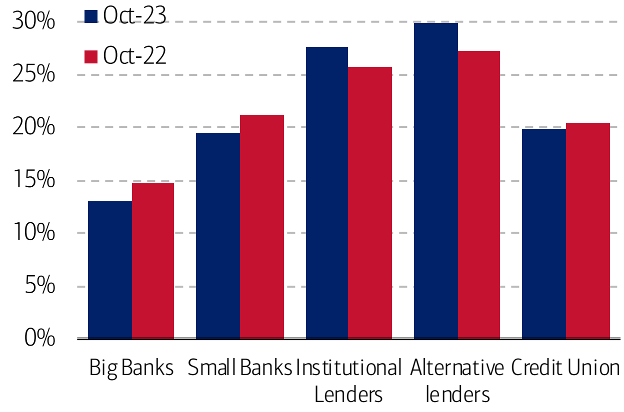
Exhibit 8: Loan approval rates by the source of funding (%)

Small businesses have higher loan approval rates at institutional lenders and alternative lenders than a year ago



Source: Biz2Credit

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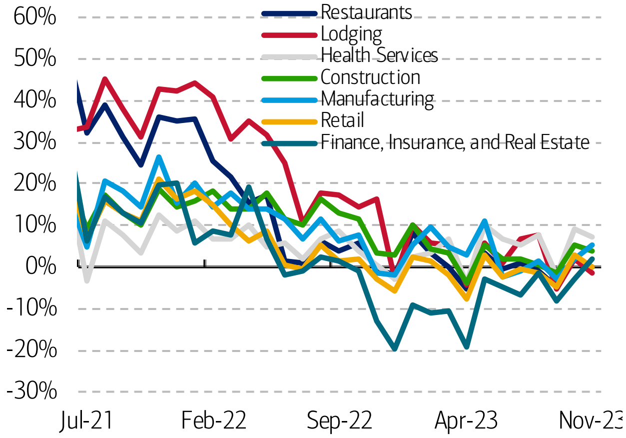
#5 Healthcare stands out from other sectors

Within sectors, we continue to see relative strength in payment spending growth for health services (Exhibit 9). As we have discussed over the past few months, there has been a growing demand for healthcare services, due in part to ageing Baby Boomers and the pandemic aftermath. This has led to the formation of new businesses, in addition to expansions for the existing firms, driving up total payments' growth.

Exhibit 9: Small business payments growth by select industries, according to Bank of America internal data (monthly, %YoY)

Small business payments growth in health services was up 7.3% YoY in November



Source: Bank of America internal data

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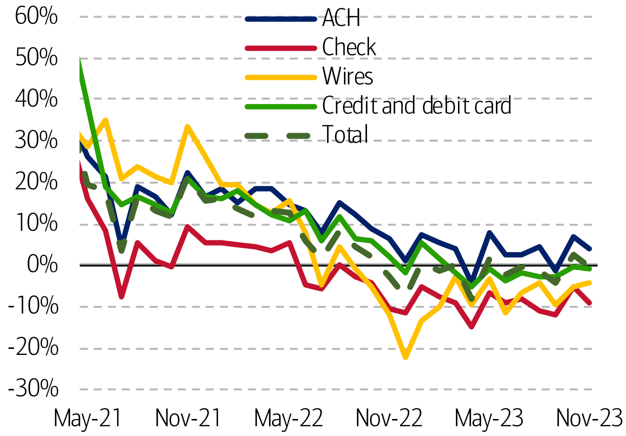
Exhibit 10: Small business payments growth by channel, based on Bank of America internal data (monthly, %YoY)

Total payments per small business client were down 0.5% YoY in November



Source: Bank of America internal data

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Monthly payments update

Looking more broadly at small business activities in November, total payments per small business client were down 0.5% YoY (Exhibit 10). Among the major components, ACH showed the largest increase, up 3.9% YoY in November, though down from 7.0% YoY in October. Conversely, the largest decrease %YoY was by check.

Methodology

Selected Bank of America transaction data is used to inform the macroeconomic views expressed in this report and should be considered in the context of other economic indicators and publicly available information. In certain instances, the data may provide directional and/or predictive value. The data used is not comprehensive; it is based on **aggregated and anonymized** selections of Bank of America data and may reflect a degree of selection bias and limitations on the data available.

Any **Small Business** payments data represents aggregate spend from Small Business clients with a deposit account or a Small Business credit card. Payroll payments data include channels such as ACH (automated clearing house), bill pay, checks and wire. Bank of America per Small Business client data represents activity spending from active Small Business clients with a deposit account or a Small Business credit card and at least one transaction in each month. Small businesses in this report include business clients within Bank of America and are generally defined as under $5mm in annual sales revenue.

Unless otherwise stated, data is not adjusted for seasonality, processing days or portfolio changes, and may be subject to periodic revisions.

Revenue tiers are determined by the combination of following factors: 1) stated revenue on small businesses credit or PPP applications, 2) actual account inflow into BofA Deposit Accounts, and 3) third party revenue estimation.

Data regarding merchants who receive payments are identified and classified by the Merchant Categorization Code (MCC) defined by financial services companies. The data are mapped using proprietary methods from the MCCs to the North American Industry Classification System (NAICS), which is also used by the Census Bureau, in order to classify spending data by subsector. Spending data may also be classified by other proprietary methods not using MCCs.

Additional information about the methodology used to aggregate the data is available upon request.

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Disclosures