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Small Business Checkpoint

Loan inflows stable amid credit tightening

15 June 2023

Key takeaways

- Despite banks reporting tightening lending conditions, Bank of America internal data shows that the average amount of loan disbursement deposited into small business accounts has not shown material slowdown over the past year. Part of the reason could be that small businesses may be turning to alternative sources of funding such as fintech companies.
- Moreover, small businesses can also seek liquidity support through factoring, which is generally used to cover daily operational costs. Interestingly, account inflow from factoring has declined more noticeably according to Bank of America internal data, down by roughly 20% year-over-year (YoY) in May. This drop likely reflects easing cash flow pressure as inflation slows.
- Small business spending in May was roughly in line with a year ago. Total payments per small business client were up 1% YoY, according to Bank of America internal data. Payroll spending was up 3% YoY with small businesses in the lodging sector showing particular strength.

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.

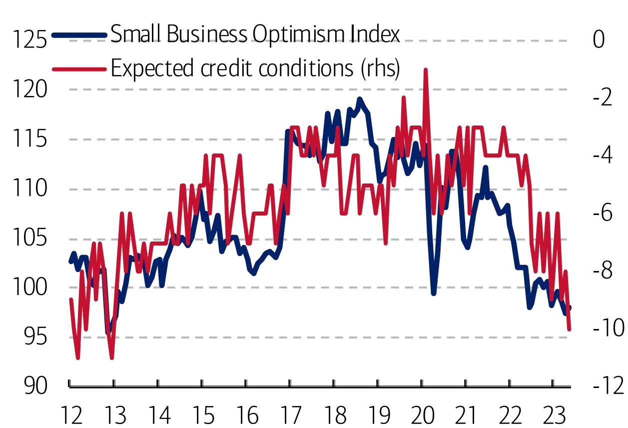
Small business loan inflow stable over the last year

Last month, we discussed the May release of the Senior Loan Officer Opinion Survey (SLOOS), which showed that banks' lending standards for commercial and industrial (C&I) loans to small firms continued to tighten and were at levels consistent with prior recessionary periods.

Meanwhile, in the May release of the National Federation of Independent Business (NFIB) survey, small businesses' expected credit conditions also dropped to the lowest level since 2012 (Exhibit 1). This has weighed on overall sentiment with the headline Small Business Optimism Index hovering near decade-lows.

Exhibit 1: Small Business Optimism Index (seasonally adjusted) and expected credit conditions (net % reporting expected tighter credit conditions)

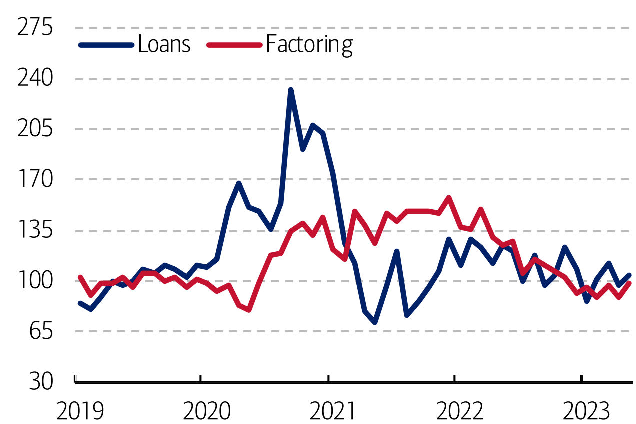
Expected credit conditions dropped to the lowest level since 2012 in May



Source: National Federation of Independent Business

Exhibit 2: Account inflow of loan and factoring disbursement per small business client, based on Bank of America internal data (index, 2019 average =100)

Small business loan financing volume is in line with 2019 levels



Source: Bank of America internal data. Note the spikes are related to pandemic related programs such as the Paycheck Protection Program and Economic Injury Disaster Loans.

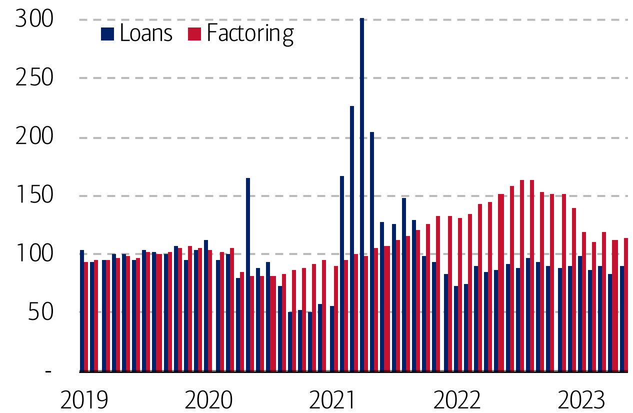
Interestingly, Bank of America internal data suggests that small business loan financing, as measured by the average amount of loan disbursement that is deposited into small business client accounts, has not shown any material slowdown over the past year and is in line with 2019 levels (Exhibit 2).

In addition, the number of small businesses receiving loan disbursements has remained stable since the start of 2022, which was well before banks started tightening lending conditions (Exhibit 3). That said, when compared with 2019, the number of businesses with loan inflows is lower, which may reflect moderation in capital expenditure plans. The latest survey from the National Federation of Independent Business finds small businesses' capital expenditure plans over the next 3-6 months are much lower than the 2019 average (Exhibit 5).

Why is loan inflow staying fairly stable while banks' lending conditions have tightened significantly? In our view, part of the reason could be that small businesses may be turning to alternative sources of funding. For example, according to the Biz2Credit Small Business Lending survey, which is based on 1,000 monthly respondents, loan approval rates across big banks, small banks, and credit unions have all declined over the past year while rates at alternative lenders (i.e. online lending fintech companies) has actually ticked up (Exhibit 4).

Exhibit 3: Number of small business clients that received a loan disbursement or factoring inflow into their accounts (index, 2019 average =100)

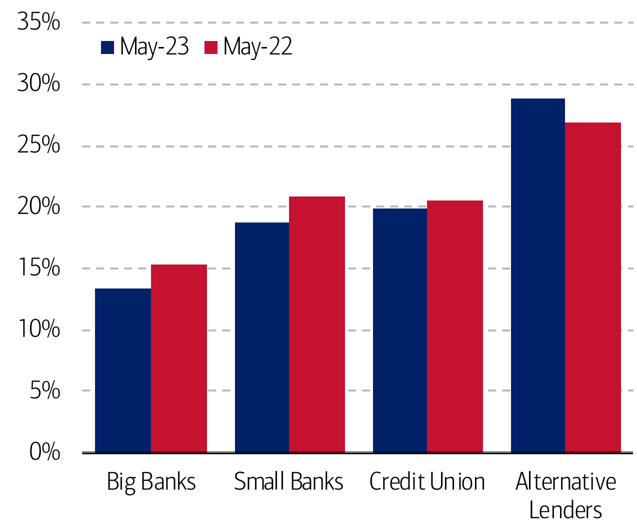
The number of small businesses receiving a loan disbursement has remained stable since the start of 2022 but is lower compared to 2019



Source: Bank of America internal data. Note the spikes are related to pandemic related programs such as the Paycheck Protection Program and Economic Injury Disaster Loans.

Exhibit 4: Loan approval rates by the source of funding (%)

Alternative lenders' loan approval rates ticked up relative to a year ago



Source: Biz2Credit

Small business factoring volume shows a bigger slowdown

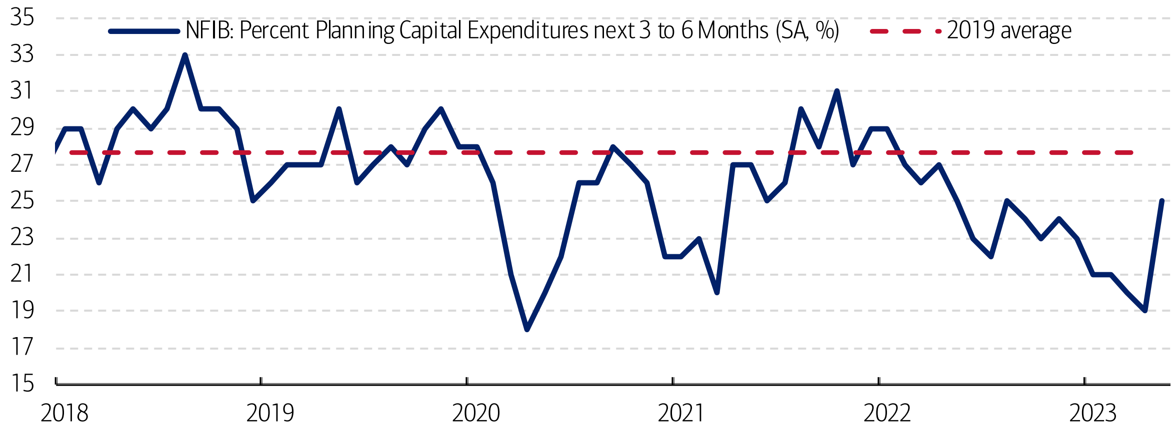
Besides getting a loan, small businesses can also seek liquidity support through other channels including factoring. Factoring is a type of financing where businesses sell their invoices to a third-party institution in exchange for short term liquidity. This method does not create additional debt for small businesses and is therefore not directly impacted by rising interest rates. Instead, a business implicitly pays for factoring by receiving a discount (usually 1-5%) to the full value of an invoice that it is selling. Any company that sells goods and services can utilize factoring though it seems to be more common in transportation and manufacturing industries.

As Exhibit 2 shows, account inflow per client from factoring declined more noticeably over the past year than loan disbursements, by roughly -20% YoY in May. Similarly, the number of businesses that are engaging in factoring also dropped meaningfully from its peak in August 2022 but remained higher than 2019 levels.

Note that factoring is generally used to cover daily operational costs and the above finding mirrors trends in cash flow pressure driven by inflation. As inflation peaked in 2022, factoring likely helped alleviate some cost pressure. Factoring usage remains above 2019 levels, but has declined since 2022 as inflation mitigates. Increased usage of factoring above 2019 levels may also reflect some credit challenges, as there is less dependency on credit approval than more traditional products like a line of credit.

Exhibit 5: NFIB: Percent Planning Capital Expenditures next 3 to 6 Months (seasonally adjusted, %)

Small businesses' capital expenditure plans over the next 3-6 months are much lower than the 2019 average



Source: National Federation of Independent Business. Dotted line means 2019 annual average.

Small business payments rebounded in May

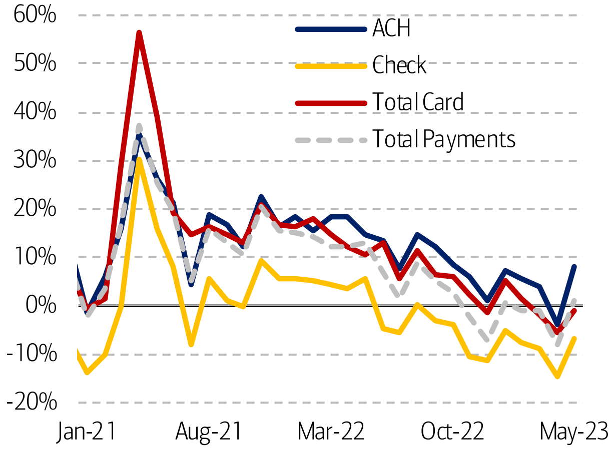
Small business payments growth rebounded in May after a weak month of April. According to Bank of America internal data, total payments per small business client, which includes Automated Clearing House (ACH), cards, wires, checks and person-to-business payments, were up 1% YoY in May. Among the major components, ACH showed the largest increase, up 8% YoY in May.

One caveat is that the rebound in May is likely partially a payback for April. This is because the last two days of April fell on a weekend, which would have pushed the processing of certain transactions into May.

Within ACH payments, payroll spending per small business client showed a slight rebound in May, to 3% YoY from 1% YoY in April (Exhibit 7). But some sectors seem to be doing better than the others. Small businesses in the lodging sector are still seeing a strong 18% YoY growth in payroll spending, signaling continued resilience in leisure and hospitality. Meanwhile the relative strength of the retail sector has faded with payroll spending now in line with aggregate trends after leading by a wide margin in 2021 and 2022.

Exhibit 6: Small business payments growth by channel, based on Bank of America internal data (monthly, %YoY)

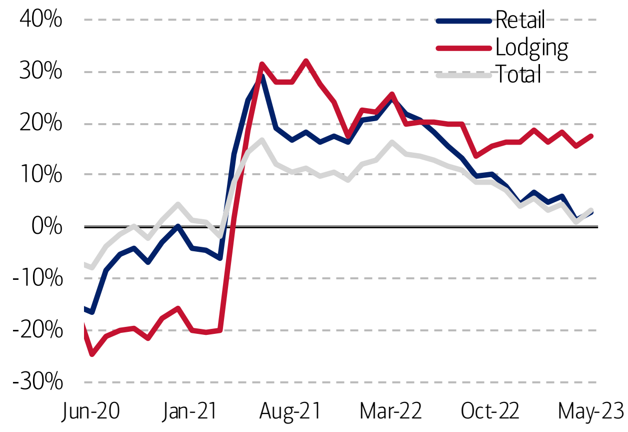
Total payments per small business client were up 1% YoY in May



Source: Bank of America internal data

Exhibit 7: Growth in small business payroll payments: total and select sectors (% YoY, 3- month moving average)

Total payroll spending per small business client increased 3% YoY in May



Source: Bank of America internal data

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.

Payments to small business-focused hiring firms include both direct deposits through Automated Clearing House (ACH) and payments via credit and debit cards.

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

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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