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Small Business Checkpoint

Less help wanted

17 January 2023

Key takeaways

- Small businesses are important for the labor market – nearly half of all US workers are employed by companies with fewer than 250 employees. This is why the latest Bank of America internal data, which shows that small business hiring seems to be moderating from historically high levels, is notable. Payroll payments per client were up 3.9% year-over-year (YoY) in December, down from 16.4% in March 2022.

- What is driving the slowdown? Besides easing wage growth, demand for workers could also be turning lower with small business profits increasingly under pressure. The ratio of inflows into Bank of America small business accounts to outflows, which we view as a proxy for profits, reached a four-year low of 0.92 in December. Our data also showed payroll payments remained more resilient for firms with less than $100k in annual revenue.

- Looking ahead, small business hiring should moderate further as the Fed presses on with rate hikes. But moderation doesn't mean contraction. A proprietary Bank of America survey of small business owners showed that 70% of respondents still plan to hire in 2023, though most intend to take on just one or two employees.

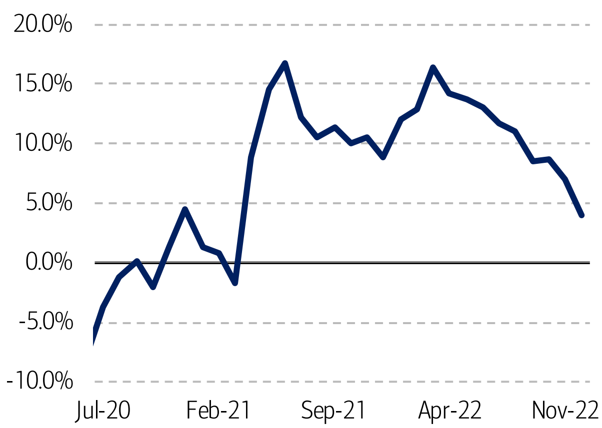
Small Business Checkpoint is a regular publication from the Bank of America Institute. It aims to provide a real-time assessment of small business spending activities and financial well-being, leveraging the depth and breadth of Bank of America's proprietary data. Such data is not intended to be reflective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

Lower profit weakens hiring demand

Small businesses play a critical role in labor markets. Nearly half of all US workers are employed at companies with fewer than 250 employees as of first-quarter 2022, according to data from the Bureau of Labor Statistics (BLS). The latest Bank of America internal data shows that small business hiring seems to be moderating. As of December, small business payroll payments per client stood at 3.9% YoY on a three-month rolling basis, down meaningfully from the high of 16.4% YoY in March 2022 (Exhibit 1).

Exhibit 1: Growth in small business payroll payments (% YoY, 3-month moving average as of December)

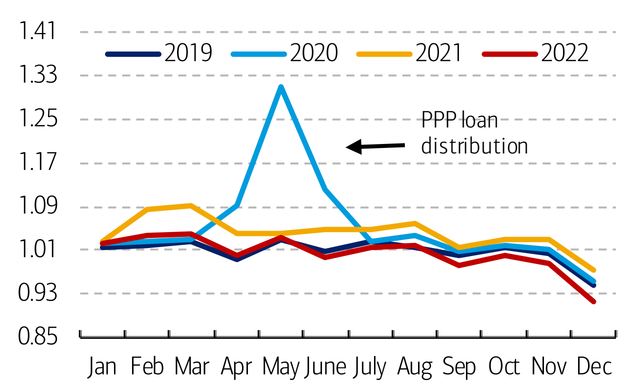
Small business payroll payments per client continue to decelerate



Source: Bank of America internal data

Exhibit 2: Inflow-to-outflow ratio for small businesses, based on Bank of America internal data (monthly, 1+ = inflow greater than outflow)

The inflow to outflow ratio for small businesses moderated this year by more than previous years



Source: Bank of America internal data. PPP = Paycheck Protection Program. **Note:** inflow to outflow ratio is based on small business checking and savings accounts at Bank of America

In our view, this moderation likely reflects a combination of two factors. First, small business profits are under pressure as Fed rate hikes weigh on the overall economy. One way to gauge profits is to look at the inflow-to-outflow ratio for small businesses' checking and savings accounts. Specifically, we view the inflow into small business accounts as a proxy for revenues (though there is a small non-revenue component, such as deposits) and outflow as expenses. A ratio of less than 1 would then imply lower revenue than expenses.

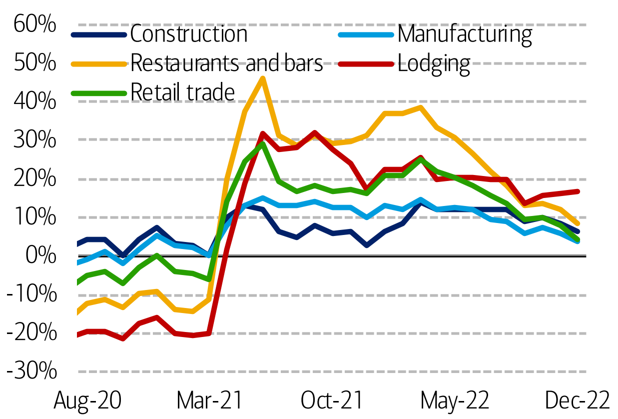
As Exhibit 2 shows, Bank of America data indicates that the small business inflow-to-outflow ratio for December stood at just 0.92 (a ratio less than 1 means inflow less than outflow), down from 0.99 in the prior month. Note that this ratio does tend to be lower in December as outflows usually increase due to annual expenses such as bonuses and debt pay down. But even knowing this ratio tends to be lower around this time of year, December 2022 witnessed the lowest inflow-to-outflow ratio across the last four Decembers. Similarly, the net share (% of respondents reporting positive minus % reporting negative) of small businesses reporting a positive earnings trend slipped by eight percentage points to negative 30% in December, according to a National Federation of Independent Business (NFIB) survey.

A shrinking profit margin for small businesses has likely led to cooling but still-strong demand for workers. In fact, the latest jobs report from the BLS provides some confirmation of this: nonfarm payrolls moderated for five consecutive months, though December still saw a solid 223k jobs added.

The second factor behind slower payroll payment growth is easing wage inflation. As we discussed in our latest Consumer Checkpoint, both average hourly earnings (AHE) from the BLS and after-tax wages and salaries that are based on Bank of America aggregated consumer deposit data have meaningfully decelerated over the past few months. In our view, slower wage growth was likely a bigger factor in sectors that saw the highest wage growth in early 2022, such as retail trade (Exhibit 3). By December 2022, AHE for retail trade had slowed to 4.1% YoY, the lowest since September 2021.

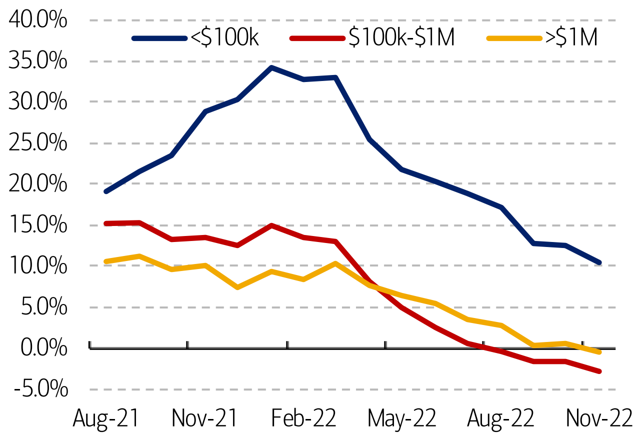
We also find a broad-based slowdown in payroll payments by revenue size, although to varying degrees. For small businesses with annual revenue of less than $100k, payroll payment growth per client remained elevated at around 10% YoY for the three months ending November 2022 (Exhibit 4). By contrast, for small businesses with annual revenue of more than $1 million, payroll payments per client are roughly flat on a year ago. What accounts for the strength for the lowest revenue tier? It could partly be that these businesses employ the fewest people, so even one additional worker hired represents a bigger percentage increase.

Exhibit 3: Growth in small business payroll payments for select industries (% YoY, 3-month moving average as of December)
Payroll payments in lodging continue to grow from last month as other sectors moderate



Source: Bank of America

Exhibit 4: Growth in small business payroll payments by revenue tier (% YoY, 3-month moving average as of November)
The lowest revenue tier maintains the strongest growth



Source: Bank of America internal data

More moderation, but not contraction, in payrolls to come

Will small business hiring continue to moderate? We think so. On an aggregated level, labor markets remain out of balance with 1.7 job openings for every unemployed person as of November 2022. To contain such an overheated labor market, the Fed is expected to press on with rate hikes over the coming months, which will eventually lead to a rise in the unemployment rate, according to BofA Global Research. Therefore, small business hiring will likely slow further.

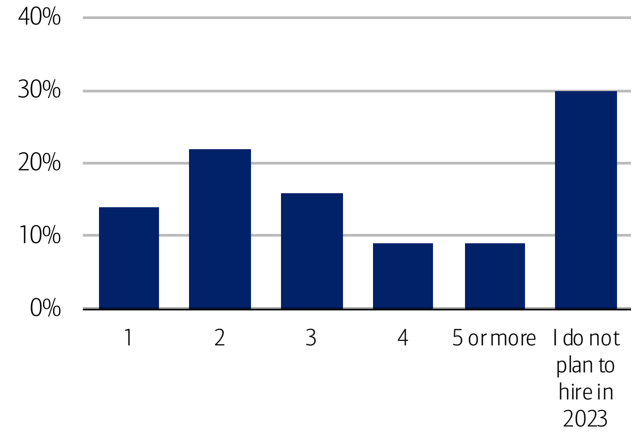
Similarly, latest data by the National Federation of Independent Business (NFIB) shows that small business intentions to hire have dropped to their lowest level since January 2021, with a net 17% of respondents saying they planned to increase employment (Exhibit 5).

But moderation does not mean contraction, at least for now. A separate survey of small business owners conducted by Bank of America in November 2022 revealed a slightly more optimistic view: around 70% of respondents, or a net of 40%, expect to hire in 2023. Of those who intend to hire, over half plan to take on just one or two employees (Exhibit 6). One caveat is that there is a difference between planning to increase total employment (NFIB survey) and planning to hire (BofA survey), as the latter might include hiring to replace departed workers and therefore not lead to an overall increase in the workforce.

Exhibit 5: National Federation of Independent Businesses (NFIB) Percentage Planning to Increase Employment (%)
December hiring sentiment is at its lowest reading since January 2021

Source: NFIB

Exhibit 6: Respondents who plan on hiring in 2023 by employee count (%)
Almost a third of respondents have no plans to hire in 2023



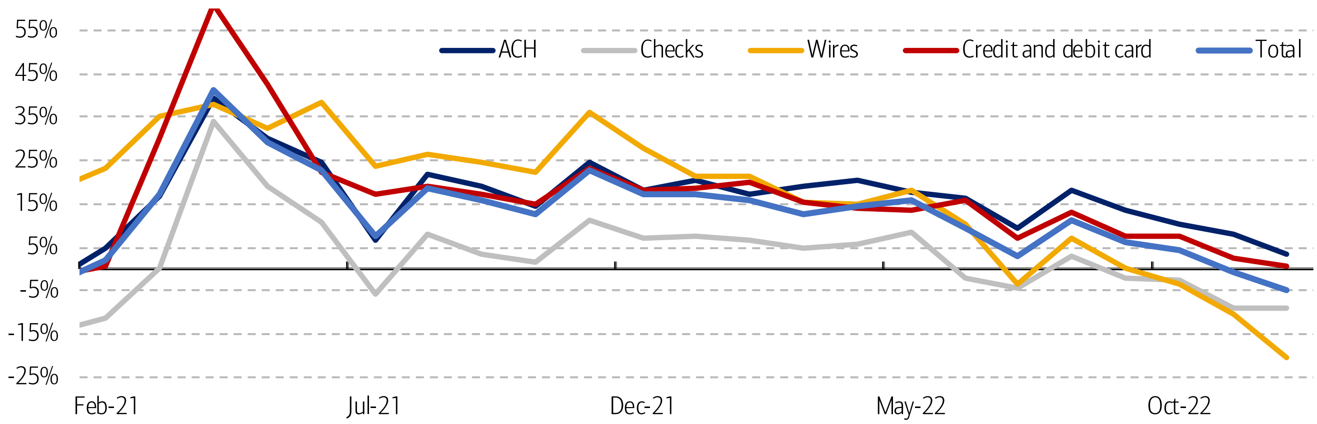
Source: Bank of America November 2022 Small Business Owner Pulse Survey. See "Methodology."

Monthly payments update

Looking beyond payroll activities, small businesses saw continued moderation across payment channels in December. Specifically, automated clearing house (ACH) and card payments per small business client were up 4% YoY and 1% YoY, respectively, down from 8% and 2% in the prior month (Exhibit 7). As a reminder, ACH captures growth in bigger-ticket items, such as rent payments, car loans/leases, and payroll, which make up a significant portion of small business operating expenses.

Notably, both check and wire volumes per small business client continued to contract on a %YoY basis in December, with wire payments down 20% YoY. In our view, this likely reflects the weakening housing market as small business owners pull back on wiring escrow payments for property purchases. This echoes a similar trend of weak wire payments by the consumer, as discussed in our latest Consumer Checkpoint.

Exhibit 7: Small business payments growth by channel, based on Bank of America internal data (monthly, %YoY)
Check and wire volumes per small business client continued to contract in December



Source: Bank of America internal data

Contributors

Anna Zhou

Economist, Bank of America Institute

Taylor Bowley

Economist, Bank of America Institute

Sources

Patrick Williams

Senior Vice President, Digital Marketing

Josh Long

Consumer Product Strategy Manager, Consumer and Small Business

Kevin Burdette

Consumer Product Strategy Analyst, Consumer and Small Business

Carol Lee Mitchell

National Strategy & Segmentation Executive, Small Business

Julie Murphy

Small Business Analytics Executive, Digital and Marketing

Chris Wong

Head of Small Business Products, Consumer and Small Business

Don Vecchiarello

Bank of America Media Relations Executive, Retail, Consumer & Small Business Products, Retirement, Small Business

Matthew Card

Bank of America Media Relations Executive, Retail, Consumer & Small Business Products, Retirement, Small Business

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 generally defined as under $5mm in annual sales revenue.

Ipsos Public Affairs conducted the Bank of America November 2022 Small Business Owner Pulse Survey online between November 18 and November 29, 2022 using a pre-recruited online sample of small business owners. Ipsos contacted a national sample of 534 small business owners in the United States with annual revenue between $100,000 and $4,999,999 and employing between two and 99 employees. The final results for the national sample were weighted to national benchmark standards for size, revenue and region.

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.

Disclosures