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## Small Business Checkpoint

# Feeling the squeeze

16 March 2023

*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.*

## Key takeaways

- Small businesses are facing crosscurrents, but headwinds from higher costs appear to be blowing slightly stronger than consumer-related tailwinds, leaving profits increasingly squeezed. In February, the ratio of inflows to outflows in Bank of America small business checking and savings accounts, which we view as a proxy for profits, was the lowest February reading over the past five years. That said, for January and February combined, net account inflow remained positive.
- Specifically, although resilient consumer spending has supported business revenues, the cost of operations for small businesses is still growing. Average rent payment growth for small businesses remains high at nearly 20% year-over-year (YoY) as of February with retail spaces seeing bigger increases than office and industrial buildings.
- Interestingly, despite economic challenges, new business formations are at historically high levels according to Census Bureau data. Demand from changing consumer preferences since the pandemic might be one driver, but we think rising interest rates and tighter lending standards mean formations will likely moderate.

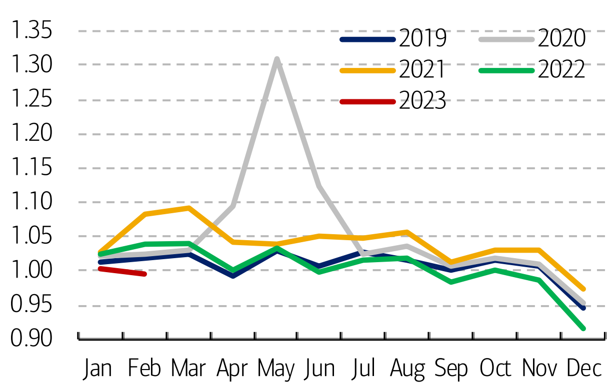
## Small businesses continue to see squeezed profits

The latest data from the National Federation of Independent Business shows that small business sentiment in February ticked up slightly but was still near its decade low. Should we worry?

In our view, small businesses are facing crosscurrents, but headwinds from higher costs appear to be blowing slightly stronger than consumer-related tailwinds, leaving profits increasingly squeezed. According to Bank of America internal data, the ratio of inflows to outflows in small business checking and savings accounts, which we view as a proxy for profits, was just 1 in February, the lowest February monthly reading over the past five years (Exhibit 1). The caveat is that, at least for now, small business account inflows are sufficient to cover outflows but should this ratio slip under 1 for an extended period it could raise concern.

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

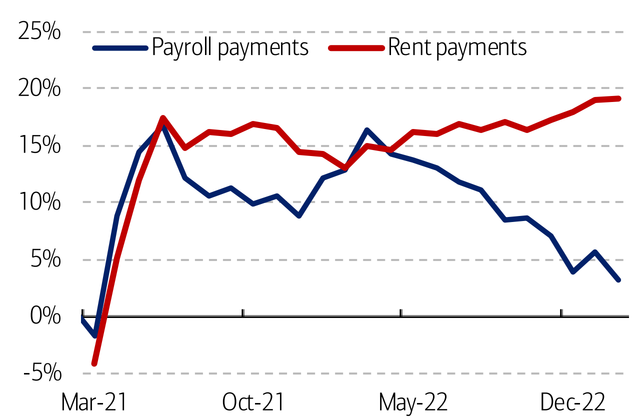
The ratio of inflows to outflows for small businesses remained lower than prior years




**Source:** Bank of America internal data

**Exhibit 2: Growth in small business payroll and rent payments (% YoY, 3-month moving average)**

Average rent payment for small businesses remains high at 20% YoY




**Source:** Bank of America internal data

### Resilient consumers support small business revenue

Let's take a closer look at both the good and bad news for small businesses. On one hand, resilient consumers are supporting sales revenue for businesses, especially those that provide services. For example, personal consumption expenditure was up nearly 8% YoY in January, according to the Bureau of Economic Analysis, two percentage points higher than the average growth rate between 2010 and 2019. Similarly, Bank of America consumer credit and debit card spending per household rose a solid 0.7% month-over-month (MoM) on a seasonally adjusted basis in February, led by a 2.3% MoM gain in services spending.

### However, high operating costs persist; retail hardest hit

On the other hand, the cost of operations for small businesses is still growing, though at a slower pace. Bank of America internal data shows that, in February, small business payments across all channels per client was up 1% YoY with automated clearing house (ACH) showing the biggest YoY increase of 8%. Keep in mind that ACH captures a significant portion of small business operating expenses, including rent payments, payrolls and car loans/leases etc.

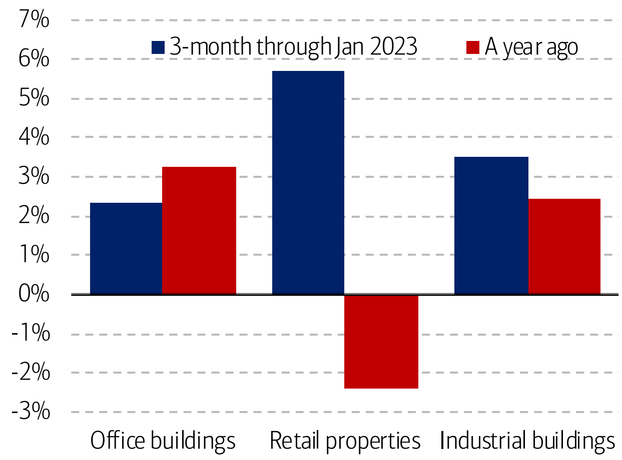
Digging deeper into the major components of ACH payments, we find diverging trends between different expense categories. For example, the growth rate of small business payroll payments has been slowing on a YoY basis since March 2022 although remained positive at around 3% YoY as of February. This is likely due to easing wage inflation as job creation remains solid.

Meanwhile, average rent payment for small businesses remains high at nearly 20% YoY with no apparent sign of easing yet (Exhibit 2). And as Exhibit 3 shows, those small businesses utilizing retail properties (such as neighborhood stores or shopping malls) are facing disproportionally higher increases in rent compared with those occupying office or industrial buildings, such as manufacturing hubs.

While broader payments growth will likely continue to moderate further in line with easing overall inflation, the rent component of expenses could be more problematic as rent prices tend to be sticky, which means they react to economic changes slowly. Therefore, even if the economy cools, rents will likely remain higher for longer.

**Exhibit 3: Select components of Nonresidential Real Estate Rents in Producer Price Index (three months ending January 2023 and 2020, %YoY)**

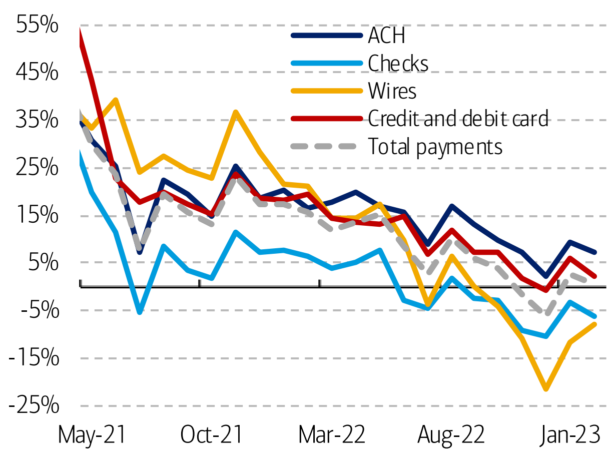
Retail spaces saw faster rent growth over the last year compared with offices and industrial buildings




**Source:** Bureau of Labor Statistics

**Exhibit 4: Small business payment growth by channel, based on Bank of America internal data (monthly, %YoY, data as of February)**

In February, small business payments across all channels per client was up 1% YoY




**Source:** Bank of America internal data

## Despite challenges, business formations are surging

Interestingly, even with the above-mentioned macroeconomic challenges, new business formations remain at historically elevated levels. Weekly data from the Census Bureau shows that high-propensity business applications – those that are most likely to turn into businesses with employees – were nearly 40% higher than the 2019 average as of March 4 on a four-week rolling basis (Exhibit 5).

What could explain this "entrepreneurship boom"? According to the US Chamber of Commerce, one reason could be that changing consumer preferences and economic needs, such as demand for virtual platforms or e-commerce, which emerged over the pandemic, are still fueling new businesses. That said, interest rates are rapidly rising and banks' lending standards have also tightened considerably over the last few quarters (Exhibit 6), both of which mean that the boom in business formation might moderate in the coming months, in our view.

**Exhibit 5: High-propensity business applications (seasonally adjusted, four-week moving average through March 4)**

High-propensity business applications – those that are most likely to turn into businesses with employees – were much higher than 2019


**Source:** Census Bureau

**Exhibit 6: Banks tightening Commercial and Industrial loans to small firms (% of banks reporting tightened standards minus % of banks reporting easing standards)**

Banks' lending standards have tightened over the last few quarters


**Source:** Federal Reserve Board

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### 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.

# Disclosures